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Electricity: It's Electric! It's Shocking! But Is It a Good?



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Creditors seeking to maximize their recoveries in bankruptcy cases have found a friend in section 503(b)(9) of the Bankruptcy Code. Section 503(b)(9) elevates the value of goods sold to and received by a debtor within 20 days of the debtor's bankruptcy filing from a general unsecured claim to an administrative expense priority claim.

Section 503(b)(9) priority claims are valuable to creditors because priority claims must be paid prior to the payment of lower priority unsecured claims, and the Bankruptcy Code requires full payment of all administrative expense priority claims (including section 503(b)(9) claims) as a condition for approval of a Chapter 11 plan.

Section 503(b)(9) always sparks significant interest among creditors, particularly when an electricity supplier is seeking an allowed priority administrative expense claim under section 503(b)(9). Only goods are eligible for priority status under section 503(b)(9), and courts are divided over whether electricity can be characterized as a good. The latest buzz in this electric story came from the Chapter 11 case of *In re North Pacific Cannery & Packers Inc.* ("NORPAC").

In *NORPAC*, the U.S. Bankruptcy Court for the District of Oregon held that electricity is not a good, and, therefore, the sale of electricity cannot give rise to a priority claim under section 503(b)(9).

Split of Judicial Authority Regarding Whether Electricity Is a "Good"

There is a roughly equal split among the courts over whether electricity is a good for purposes of Section 503(b)(9) of the Bankruptcy Code. The Bankruptcy Code does not define the term goods, so the courts have looked to other sources for an understanding of its meaning in the context of Section 503(b)(9). 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."

Therefore, determining whether electricity is a good depends 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 identified to the contract when the electricity passes through a meter—*i.e.*, while the electricity is still moving. This 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)*.

Other courts have adopted the contrary view 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. At that point, the electricity is no longer movable and therefore is not a good as defined under the UCC. This view has been adopted by courts in districts with some of the more historically active bankruptcy dockets in the country, such as the Southern District of New York in 2015, in *In re Great Atl. & Pac. Tea Co. (A&P)*, the District of Delaware in 2013, in *In re NE Opco, Inc.*, and the Northern District of Texas in 2009, in *In re Pilgrim's Pride Corp. (Pilgrim's Pride)*. The NORPAC court is the latest to join in this view.

Background Regarding the NORPAC Decision

North Pacific Cannery & Packers (Debtor) filed a Chapter 11 petition on August 22, 2019 (petition date). The Debtor's utility supplier, PacifiCorp, filed an unsecured proof of claim in the total amount of \$502,230.73 for electricity provided to the Debtor prior to the petition date. PacifiCorp asserted that \$206,009.81 of the claim was entitled to priority treatment as an administrative expense claim under section 503(b)(9) of the Bankruptcy Code (*i.e.*, a "503(b)(9) claim"), for the value of electricity PacifiCorp had supplied to the Debtor during the 20-day period prior to the petition date. The Debtor objected to PacifiCorp's 503(b)(9) claim and sought to reclassify it as a general unsecured claim, arguing that the claim is not entitled to administrative expense priority because electricity is not a good within the meaning of section 503(b)(9).

On January 27, 2021, the bankruptcy court held an evidentiary hearing during which the Debtor and PacifiCorp each presented expert testimony, including written reports from two experts in the field of physics that were filed in advance of the hearing. PacifiCorp filed expert reports of Dr. Shawn Kolitch (Kolitch Reports)—the same expert that PacifiCorp had used in the *Escalera* case, where PacifiCorp was successful in proving that electrical energy is a good because electrical energy is both identifiable and moving as it passes through the customer's meter.

However, the NORPAC bankruptcy court concluded the Kolitch Reports included "multiple improper statements of Kolitch's legal opinion that electricity [qualifies] as goods within the meaning of [section] 503(b)(9)." The bankruptcy court admitted the Kolitch Reports into evidence, but with the limitation that the court would not consider Kolitch's conclusion that electricity qualifies as a good for purposes of section 503(b)(9) as evidence in its decision.

Meanwhile, the Debtor filed an expert report that PacifiCorp had stipulated to be admissible into evidence. In his report, the Debtor's expert testified that electricity is not measured (*i.e.*, identified) by the meter until after it has been consumed. Electricity no longer exists, and therefore cannot be moveable at the time of *identification* by the meter. The Debtor's expert stated:

Meters only monitor the electricity they see passing by; they do not store it or somehow set it aside. The meter takes what it has seen and processes this information with its internal circuits. This takes time; meanwhile, the electricity is flowing beyond the meter at a speed of almost 186,000 miles per second. The processing time is immaterial because any amount of time is too much; the electricity wave is moving too fast. When the meter finally displays what it saw, it is reporting on something it saw in the past that is no longer there. For something to be moveable, you must be able to identify it and have access to it, which is part of the process of moving it. Because the electricity has already passed by, it can no longer be accessed, so it cannot be moved, and is therefore not moveable!

The Bankruptcy Court's Decision

The NORPAC court held that electricity is not a good entitled to administrative expense priority under Section 503(b)(9). In reaching this conclusion, the court relied upon the UCC's definition that goods mean "all things ... which are moveable at the time of identification to the contract of sale." The bankruptcy court noted that courts have widely accepted the UCC's definition of goods when analyzing section 503(b)(9) in light of the importance

of uniformity when interpreting federal statutory law. Against this backdrop, the court noted that the only dispositive issue in dispute in NORPAC was whether the electricity that PacifiCorp had provided to the Debtor was moveable at the time it was identified to the contract of sale.

The Debtor and PacifiCorp (and their respective experts) disagreed over whether the electricity PacifiCorp had provided to the Debtor was *moveable* when it was identified to the contract. PacifiCorp argued that electricity is identified to the contract at the instant it passes through a meter, and the electricity is movable at that time. The Debtor argued that electricity is identified to the contract when the meter can register and display the usage at which point the Debtor had already consumed the electricity and the electricity was not movable.

The bankruptcy court agreed with the Debtor that electricity is not a good. The court was persuaded by the Debtor's expert testimony that electricity is *identified* when measured by the meter, and, at that moment, the electricity no longer exists. The fact that electricity passes through the meter and is arguably *moveable* at that moment is not dispositive because the electricity is not identified to the contract at that time within the meaning of the UCC.

The bankruptcy court concluded that *Escalera* and its like-minded courts were not presented with the type of evidence that the Debtor had presented at the trial regarding the nature of electricity and how meters work. Courts that have been presented with such evidence, such as the courts in *A&P* and *Pilgrim's Pride*, have uniformly held that that electricity is not a good because the meter does not identify the electricity until after it has been consumed, and, as a result, electricity is not moving at the time of identification. The bankruptcy court found that the *Escalera* decision and other supporting case law merely assumed that electricity is identified to the contract at the moment it passes through a meter without analyzing what it means to identify goods to a contract or ascribing any meaning to the concepts of identification and movability.

The court rejected PacifiCorp's position that electricity is identified to the contract at the moment it passes through the meter because PacifiCorp had improperly equated *identifiable* with *identified*. Although electricity may be identifiable once it passes through a meter, it takes a period of time for the meter to register and display the usage (and, therefore, for the electricity to be identified to the contract under the UCC). Since the electricity travels at close to the speed of light, it has already been consumed and, thus, is not movable by the time it has been identified.

The bankruptcy court also found that even if electricity is identified at the moment it passes through the meter, the electricity still does not qualify as a good because it is not moveable at that time. In this regard, the bankruptcy court concluded that PacifiCorp had incorrectly equated the fact that an object is moving with that object being movable. The bankruptcy court relied on the Debtor's expert testimony that, although electricity is moving when it passes through a meter, electricity can only be consumed by the device that closed the circuit and caused the electricity to flow through the meter. Similar to the earth spinning on its axis or the Empire State Building swaying in the wind, electricity may be moving at the time it passes through the meter, but it is not moveable because no one could conceivably move it.¹

Conclusion

The *NORPAC* decision indicates that the issue of whether electricity is a good will likely continue to be hotly contested. This issue can have an impact beyond whether a certain utility provider can obtain an administrative expense priority claim in a bankruptcy case. For example, in connection with the *NORPAC* decision, PacifiCorp has indicated that the final resolution of this issue could impact the rate adjustments it will seek from the Oregon Public Utilities Commission.

The *NORPAC* decision is particularly interesting considering the *NORPAC* court explicitly rejected the *Escalera* decision, which was based on the very same expert's testimony that PacifiCorp had presented in the *NORPAC* case. That said, the *NORPAC* decision is a live wire because PacifiCorp has appealed the *NORPAC* decision to the U.S. District Court for the District of Oregon. Stay plugged in! 

- 1 PacifiCorp had alternatively argued that electricity qualifies as a good because it is possible 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)]. However, the bankruptcy court swiftly 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, there was no evidence that the Debtor had stored the electricity obtained from PacifiCorp.

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