

Treatment of utilities under new bankruptcy law:

Bad news for debtors, good news for utilities and DIP lenders,

On October 17, 2005, the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 ("BAPCPA") came into effect amending a significant number of provisions of the Bankruptcy Code. While BAPCPA's primary purpose was to impose more rigorous requirements for consumer bankruptcies, it has changed several important aspects of business bankruptcies as well.



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Among the most important amendments impacting a chapter 11 debtor's ability to reorganize are the additions to § 366 of the Bankruptcy Code. The amended § 366 significantly improves utilities' leverage in chapter 11 bankruptcy cases while increasing debtors' immediate need for cash and jeopardizing their ability to stay in chapter 11.

Section 366 before BAPCPA

The original § 366 was intended to prevent utility companies from refusing to deliver services to bankruptcy entities while providing utilities with assurance of payment. Thus pre-BAPCPA, § 366(a) provided that a utility could not "alter, refuse, or discontinue service to, or discriminate against" the debtor solely on the basis of the debtor's bankruptcy status. Subsection (b) of the old § 366 permitted utilities to alter, refuse, or discontinue service if, within 20 days after the order for relief, the debtor failed to provide "adequate assurance of payment, in the form of a deposit or other security."

Before BAPCPA, courts often allowed debtors to avoid providing a deposit or other form of security by demonstrating a pre-petition history of timely payments made to the utility. In the alternative, debtors could provide adequate assurance of future payment to utilities by allowing an administrative expense for any post-petition services provided by the utilities.

New Section 366

BAPCPA did not make any significant changes to § 366(a) and (b). However, it added a new subsection (c), which defined "assurance of payment" as "(i) a cash deposit; (ii) a letter of credit; (iii) a certificate of deposit; (iv) a surety bond; (v) a prepayment of utility consumption; or (vi) another form of security that is mutually agreed on between the utility and the debtor or the trustee." In contrast to the old bankruptcy law, § 366(c) expressly provides that an administrative expense priority does not constitute

an assurance of payment.

The new § 366(c) also permits a utility to alter, refuse or discontinue utility service if, during the 30-day period commencing on the date of the bankruptcy filing, the debtor does not provide the utility with adequate assurance of payment "that is satisfactory to the utility."⁶ Thus, under the new subjective standard for adequate assurance, debtors who are unable to negotiate an agreement on assurance of payment

Who Qualifies as a "Utility"?

Although BAPCPA defined what constitutes "assurance of payment" for the purpose of § 366, it did not clarify all existing ambiguities with respect to the treatment of utilities in bankruptcy. In fact, just like the old statute, the amended § 366 does not define what entities qualify as a "utility" under the new Bankruptcy Code.

This ambiguity becomes particularly pertinent in bankruptcies filed

October 17, 2005, one court has already tackled the issue of the application of § 366 to providers of telecommunication services. Lucre, Inc. was a reseller of telecommunication services, who filed its chapter 11 petition on October 21, 2005. It received telecommunication services from three providers, Sprint, IXC Direct and Opex Communications. The court held that Sprint was clearly entitled to adequate assurance of payment under § 366 because it provided the debtor with long-distance services strictly for the debtor's internal use. IXC and Opex, however, did not qualify for the § 366 treatment because Lucre purchased their services for resale to its own local Michigan customers. Thus, at least according to the Lucre court, a telecommunication provider is entitled to the protections of § 366 only if it provides the debtor with traditional utility services that the debtor itself consumes.

What's a Debtor to Do?

Although in cases involving telecoms and other resellers of utilities courts will have the last word on whether wholesale providers of utility services are always entitled to the protections of the amended § 366, there is no doubt that, as a practical matter, § 366(c) has dramatically increased debtors' need for cash immediately following the commencement of a bankruptcy case. Careful budget planning prior to the commencement of a bankruptcy case will become a must for any debtor trying to survive a chapter 11. Yet, most debtors will not be able to meet the demands of the amended § 366 without asking for more cash from their DIP lenders.

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with their utility providers will have a very difficult case of convincing the court of the adequacy of their proposal. Notably, § 366(c) does not require utilities to obtain a court order prior to refusing or discontinuing service.

Although § 366(c) allows the court to modify the amount of an assurance payment on request of a party in interest and after notice and a hearing, it further provides that the court may not consider the absence of security or the debtor's timely payment history prior to the petition. Finally, BAPCPA significantly increased utilities' negotiating power by allowing them to set off against a debtor's pre-petition security deposit without notice or a court order.

by providers of telecommunication services, such as local and long distance telephone services, cellular telephone and internet service. Companies that purchase telecommunication services in bulk from larger utility providers for resale to end-users are not typical consumers of utilities. In an effort to limit their cash flow, bankrupt resellers of telecommunication services have tried to argue that wholesalers of such services do not qualify as a "utility" within the meaning of § 366 and, instead, should be treated just like any other wholesaler of products. However, prior to the enactment of BAPCPA, courts had been reluctant to recognize this argument.

Since BAPCPA's effective date of

¹11 U.S.C. §§ 101 et al.

²11 U.S.C. § 366(a), (b).

See *In re Anchor Glass Container Corp.*, No. 8:05-bk-15606-ALP, 2005 WL 3334536, at *2 (Bankr. M.D. Fla. Nov. 16, 2005) (citing *Virginia Elec. & Power Co. v. Caldor, Inc.*, 117 F.3d 646 (2d Cir. 1997); *In re Adelphia Bus. Solutions, Inc.*, 280 B.R. 63 (Bankr. S.D.N.Y. 2002)).

³11 U.S.C. § 366(c)(1)(A).

⁴11 U.S.C. § 366(c)(2)(B).

⁵11 U.S.C. § 366(c)(2).

⁶11 U.S.C. § 366(c)(3).

⁷11 U.S.C. § 366(c)(4).

In re Tel-Central Communications, Inc., 212 B.R. 342 (Bankr. W.D. Mo. 1997).

In re Lucre, Inc., 333 B.R. 151 (Bankr. W.D. Mich. 2005).