# First Impression

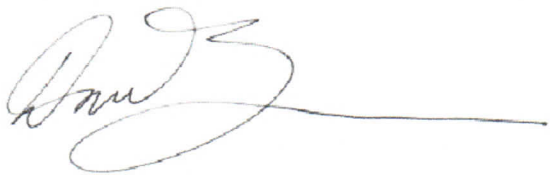
## It Is a Far, Far Better Issue That I Do, Than I Have Ever Done

One of the key discoveries when editing a magazine is realizing how quickly things can change. For much of the process of planning and creating this issue, the June edition was thought of as the biomass issue. Inside the issue, we have two key articles on biomass: William Atkinson's article on the broader issues with biomass on page 20 and Alice Clamp's article on biomass at Gainesville Regional Utilities in Florida on page 24. If you head over to PublicPowerMedia.org, you can also check out an article on water transport for biomass that we've made Web-only.

But as we were developing ideas for the biomass cover, in came Alice Clamp's article on the RTO situation in PJM Interconnection and ISO New England (page 12). We immediately realized that it would be a disservice to our readers to sit on this timely and important article because of finished layouts and production schedules. Thankfully, Alice gave us a good place to start from: by connecting her article to Charles Dickens' *A Tale of Two Cities*, the development of Ralph Butler's cover was a breeze.

Also inside you'll find an overview of the recipients of this year's APPA awards (page 28). Since the June issue is distributed at the APPA National Conference (this year in Washington, D.C., June 19 to 22), we love to take this opportunity to supplement the awards process by highlighting the winners' achievements. If you're reading this at the conference, be sure to keep an eye out for these public power leaders; if you are reading this at home, be sure to look over all the great work your colleagues are doing around the country and be sure to nominate anyone you think should be considered for these awards at next year's APPA National Conference in Seattle, Wash., June 16 to 20, 2012.

Rounding out this rump issue of public power are a trio of Public Power On the Road articles, each profiling APPA member utilities in North Carolina (page 48), a look at invasive plants such as kudzu (page 64), and an interview with North American Electric Reliability Corp. CEO Gerry Cauley (page 42).



David L. Blaylock

## PublicPowerMedia.org

Not everything can make it into an issue, so check out PublicPowerMedia.org for more on the stories printed here, including extended coverage, photo galleries, and videos.

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### Protecting Your Utility When a Customer Files for Bankruptcy

When Blockbuster Video filed for bankruptcy under Chapter 11 last year, it turned out that, among the nine public power utilities with the largest average monthly invoices in the prior year, seven were selling to Blockbuster on a 100 percent unsecured basis (without any security deposit or surety bond/letter of credit). Without adequate assurance of payment, whether from non-debtor or Chapter 11 customers, a public power utility stands to incur bad debt expenses and higher cash working capital requirements—costs that ultimately are passed on to other customers through higher rates.

### Will Biomass Barge In?

You can ship it across the ocean, but you may not be able to truck it in from the next town: biomass. Utilities converting coal burners to include a biomass mix face a new set of logistics in distance. How far away can one afford to bring in biomass? It's renewable, but it's lower in energy than coal and not as dense. Co-firing means power-plant operators have some thinking to do. Navigable waterways may give power plants an advantage in switching to biomass—but it's complicated.

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# Protecting Your Utility When a Customer Files for Bankruptcy

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By Gilbert L. Hamberg

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The bankruptcy filings by Blockbuster Video and Borders book stores drive home the points that the economy is not out of the woods and that electric utilities need to be prepared to deal with commercial and industrial bankruptcies.

The Blockbuster case offers a particular lesson. When the video chain filed for bankruptcy under Chapter 11 last year, it turned out that, among the nine public power utilities with the largest ($8,000 or more) average monthly invoices in the prior year, seven were selling to Blockbuster on a 100 percent unsecured basis (without any security deposit or surety bond/letter of credit). By contrast, only half (22 of 44) of investor-owned utilities with large monthly invoices had no security deposit or equivalent.

Without adequate assurance of payment, whether from non-debtor or Chapter 11 customers, a public power utility stands to incur bad debt expenses and higher cash working capital requirements, costs that ultimately are passed onto other customers through higher rates.

This article addresses the two key issues affecting a public power utility when a commercial customer files a petition for bankruptcy under Chapter 11: (1) adequate assurance of payment for post-petition charges under Section 366(c); and (2) what happens when a bankrupt customer fails to pay for post-petition charges.

### *Adequate assurance of payment*

Generally, a public power utility sells electricity to commercial customers on a monthly cycle, with a financial risk of loss of about 60 days (ranging from the billing period to termination due to non-payment, if necessary). To protect itself against that risk, a prudent public power utility should consider assessing a security deposit (or its commercial equivalent) equal to two or more months of charges.

In the *Blockbuster* case, one public power utility held a surety bond equal to more than three times the average monthly invoice, and another held a surety bond equal to more than four times the average monthly invoice. Compare this with one IOU, which held a surety bond equal to more than 10 times the average monthly invoice.

When a commercial customer files for Chapter 11, a public power utility that is already armed with a sufficient security deposit can set off or recoup that deposit against the debtor's unpaid pre-petition charges—without Bankruptcy Court authorization. That can eliminate, or at least minimize, any losses for electricity bills incurred prior to the filing of the bankruptcy petition. A utility then can

proceed to request adequate assurance of payment under Section 366(c) of the Bankruptcy Code for charges for the bankrupt company's post-petition usage. A prudent public power utility will seek to assess a post-petition security deposit equal to the length of a monthly billing cycle; *e.g.*, 60 days. Significantly, Section 366(c)(2) now requires adequate assurance of payment to be "satisfactory to the utility."

Congress enacted Section 366(c) in 2005 as a reaction to cases such as *In re Caldor, Inc.* where no post-petition deposits were assessed and adequate assurance of payment was limited ostensibly to mere administrative expense priority.[1] Ironically, *Caldor* became administratively insolvent, and utilities and other trade creditors were not paid in full for invoices rendered during the Chapter 11 proceeding.[2]

In major Chapter 11 cases, debtors frequently file their own motions as to what should constitute adequate assurance of payment under Section 366. Typically, they propose that the debtor need only post a security deposit in an escrow account at its bank, controlled solely by the debtor, in an amount equal to the two-week average of all of its utilities' charges—but only for utilities with no pre-petition security deposits or that do not bill in advance.

A prudent public power utility with an active post-petition account definitely should oppose such relief for these key reasons: (1) Section 366(c)(1)(A) of the Bankruptcy Code sets out the only acceptable forms of assurance of payment[3]; (2) an escrow account at the debtor's bank is not the same as a cash deposit held by the utility; and (3) as the financial risk to sell electricity to a commercial customer on monthly billing lasts about 60 days, a 15-day deposit hardly should constitute relief satisfactory to the utility, which is expressly mandated in Section 366(c)(2).

In response to such a motion by a debtor, a prudent public power utility should request that the bankrupt company post a security deposit equal to two months of usage, calculated per the requirements of state or local law. Bankruptcy courts have differed on the size (one month versus two) of security deposits under Section 366(c). In one case (*In re Lucre, Inc.),* the court ruled that the debtor "has no recourse to modify the adequate assurance payment the utility is demanding until the . . . debtor . . . actually accepts what the utility proposes."[4] The legislative history states that the Chapter 11 debtor must pay the adequate assurance satisfactory to the utility within 30 days of the petition date, or the utility can terminate service. After that payment, the debtor can file a motion seeking modification of what constitutes adequate assurance of payment.[5]

These rulings on adequate assurance under Section 366(c) followed the U.S. Fifth Circuit Court of Appeals decision (*In re Sec. Inv. Prop., Inc.*). In that case, the court held that the bankrupt commercial customer had to pay the utility a two-month deposit, and that a utility does not have a "duty to provide unsecured future service."[6]

For bankrupt commercial customers that are unable to afford a standard deposit, a public power utility might want to offer alternative billing terms, such as semi-monthly invoices or advance payment, with lower security deposits and adjustments for overpayments or underpayment.[7] Alternate billing options help reduce a public power utility's cash working capital borrowing requirements, as the delay between selling electricity and receiving payment is reduced.

***Non-payment of post-petition invoices***

If a company fails to pay an invoice after it has filed for bankruptcy under Chapter 11, a public power utility may proceed with termination without Bankruptcy Court authorization, although the utility still must comply with applicable state and local law termination procedures. Section 959(b) of the U.S.

Judicial Code requires a bankrupt company or trustee to comply with the same state and local laws as would apply if it were not in bankruptcy.[8]

In cases involving termination due to non-payment of a utility bill, the highest legal authorities, *Robinson v. Michigan Con. Gas Co.*[9] and *Begley v. Philadelphia Elec. Co.*[10], ruled that a Bankruptcy Court does not even have jurisdiction over non-payment of a post-petition utility invoice. A number of lower courts have permitted utilities to cut off service unilaterally due to non-payment of post-petition invoices, so long as the utility first complied with state and local termination procedures.[11]

***Conclusion***

There are critical financial reasons why a public power utility should not sell to a commercial customer on a 100 percent unsecured basis. The Chapter 11 case may crater. In that event, there may be: (1) insufficient funds to pay all administrative expenses; (2) the Chapter 11 case may be dismissed without paying administrative expenses in full; and/or (3) the Chapter 11 case may be converted to Chapter 7; then Chapter 7 administrative expenses have higher priority than those in the Chapter 11.[12]

The post-petition security sought by a prudent public power utility (assessed under the state/local formula) would reduce the financial risk of loss for selling on credit to a Chapter 11 debtor. If the Chapter 11 debtor successfully reorganizes and pays all of the public power utility's post-petition charges, then neither the debtor nor the utility incurs losses, and the deposit could be returned under applicable state and local laws. There would be no loss to the estate.

Bankruptcy does not change the fact that state and local laws must be obeyed by all. A utility cannot pick which state and local laws to obey and which to ignore. Nor may a customer dictate the terms under which it will agree to be a utility's customer. In *Lewis v. Potomac Electric Power Co.,* the D.C. Circuit Court of Appeals ruled that a customer "has no positive right to compel the power company to furnish service to him contrary to its own rules and regulations."[13]

Finally, the aggressive steps recommended here for public power utilities to reduce their losses when a commercial customer files for Chapter 11 should be implemented before and after bankruptcy. The net effects—making each commercial customer pay for all of its charges, no more, no less, and keeping rates as low as possible—are goals that all customers would favor.

1. 3 *Collier on Bankruptcy*, ¶366.03[1], at 366-7 (15th ed. rev. 2009).

2. *Pearl-Pit Gmt Ltd v. Caldor Co.*, 266 B.R. 575 (S.D.N.Y. 2001).

3. According to *In re New Rochelle Tel. Co.*, 397 B.R. 633, 639 (Bankr. E.D. N.Y. 2008); *In re Beach House Prop., LLC*, 2008 WL 961498 (Bankr. S.D. Fla. 2008); *In re Astle*, 338 B.R. 855, n. 13, 860 (Bankr. D. Id. 2006); and *In re Lucre, Inc.*, 333 B.R. 151, 153-154 (Bankr. W.D. MI 2005), assurance of payment only can be one of the expressly enumerated forms of relief in Section 366(c)(1)(A), ***and none other***. *See also Collier on Bankruptcy*, ¶ 366.03[1], at 366-7 (statute "limits the types of adequate assurance that can be provided"). An escrow account is not listed in Section 366(c)(a)(A)(i). Therefore, it cannot qualify as a form of assurance of payment.

4. *In re Lucre, Inc.*, 333 B.R. 151, 154 (Bankr. W.D. MI. 2005).

5. *H.R. Rep. No. 109-31*, at 155, April 8, 2005, *reprinted in* 2005 U.S.C.C.A.N. (109th Cong., 1st Sess.).

6. *In re Sec. Inv. Prop., Inc.*, 559 F.2d 1321, 1325-6 (5th Cir. 1977).

7. *In re Penn Central Transp. Co.*, 467 F.2d 100, 104 (3rd Cir. 1972).

8. *Midlantic Nat. Bank v. N.J. Dept. of Envir. Protection*, 474 U.S. 494, 502-505 (1986).

9. *Robinson v. Michigan Con. Gas Co.*, 918 F. 2d 579 (6th Cir. 1990).

10. *Begley v. Philadelphia Elec. Co.*, 760 F.2d 46 (3d Cir. 1985).

11. *In re Weisel*, 428 B.R. 185 (W.D. Pa. 2010) (and by doing so, a utility does not violate the automatic stay provisions of the Bankruptcy Code); *In re Conxus Commun., Inc.*, 262 B.R. 893 (D. Del. 2001); *In re Sheehan Memorial Hosp.*, 301 B.R. 777 (Bankr. W.D. N.Y. 2003); *In re C.T. Harris, Inc.*, 295 B.R. 405 (Bankr. M.D. Ga. 2003); and *In re Best Prod. Co.*, 203 B.R. 51 (Bankr. E.D. Va. 1996).

12. 4 *Norton Bankruptcy Law & Practice 2d* § 87.17, at 87-77 – 87-81 (1994 ed.).

13. *Lewis v. Potomac Elec. Power Co.*, 64 F.2d 701, 702 (D.C. Cir. 1933).

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