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FROM THE EDITOR

Serving a Bankrupt Member

This month's editorial was authored by Tyrus H. Thompson, NRECA Senior Corporate Counsel.

Unfortunately, the condition of the economy is causing many businesses and individuals to file for bankruptcy. These businesses and individuals include electric cooperative members. Electric cooperatives, therefore, need to be familiar with federal bankruptcy law governing the provision and/or termination of electric service to bankrupt members.

Background of Section 366

Before 1978, federal bankruptcy statutes did not address utility service. Courts disagreed whether a utility could threaten to discontinue service as a means of collecting utility bills.[1] On November 6, 1978, Congress enacted Bankruptcy Code[2] section 366. Section 366 addresses "utility service."[3]

As explained by the U.S. Senate and House of Representatives Committees on the Judiciary, section 366 protects debtors from "cut-off of service by a utility because of the filing of a bankruptcy case." It covers utilities with "some special position" regarding the debtor, like "an electric company…that is a monopoly in the area so that the debtor cannot easily obtain comparable service from another utility."[4]

Congress enacted section 366 to guide courts regarding the extent that utilities could be treated differently than other creditors. Unlike other creditors, who may usually decline to engage in business with a bankrupt debtor, a utility is often required to continue serving the debtor.[5] Section 366 is consistent with the broad automatic stay provisions of Bankruptcy Code section 362, and the broad executory contract and unexpired lease provisions of section 365.[6] Section 366 does not require a guarantee of payment for utility service, but protects a utility from an unreasonable risk of nonpayment.[7]

As originally enacted, section 366 included subsections (a) and (b). After a clarifying amendment to section 366(a) in 1984,[8] Congress added section 366(c) in 2005.[9]

Section 366(a)

Under section 366(a), and except as provided in subsections (b) and (c), a "utility" may not "alter, refuse, or discontinue service to, or discriminate against" a bankruptcy trustee or debtor "solely" because a bankruptcy case was commenced, or "solely" because the debtor did not pay the utility, when due, a debt for "utility service" rendered before the case was commenced.[10] While the Bankruptcy Code does not define a "utility," an electric cooperative is usually considered a "utility" under section 366.[11]

As discussed below, sections 366(b) and (c) address a utility's ability to alter, refuse, or discontinue service. They do not, however, address a utility's ability to "discriminate" against a bankruptcy trustee or debtor. Under section 366(a), therefore, a utility may not "discriminate."[12]

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Section 366(b)

Under section 366(b), the utility may "alter, refuse, or discontinue service" if neither the bankruptcy trustee or debtor, within 20 days after the case was commenced, furnishes "adequate assurance of payment, in the form of a deposit or other security, for service" rendered after the case was commenced. Upon a party's request and after notice and a hearing, a court may order "reasonable modification" of the deposit amount or other security "necessary to provide adequate assurance of payment."[13]

While the assurance of payment under section 366(b) is often a deposit, section 366(b) does not address the amount of the deposit. Although courts frequently refer to state utility commission regulations governing deposits, they may, based upon the circumstances, set a deposit amount different than the regulations.[14] Unless a court orders otherwise, provision of adequate assurance of payment under section 366(b) does not prevent a utility from terminating service if the debtor fails to pay for utility service rendered after the commencement of the case. The utility, however, must comply with "nonbankruptcy law" governing the termination of service.[15]

Before the addition of section 366(c), courts sometimes ruled that timely payment of utility bills before commencing a bankruptcy case, allowance of an administrative expense priority,[16] and other minimal protections constituted adequate assurance of payment for future utility service.[17] Also, courts disagreed regarding the extent, if any, that the section 362 automatic stay limited or prevented a utility from setting off or recouping a utility deposit provided before the commencement of a bankruptcy case without a court granting relief from the stay.[18]

Section 366(c)

Section 366(c) is effective for bankruptcy cases commenced on or after October 17, 2005.[19] It applies to "reorganization" cases commenced under Bankruptcy Code chapter 11. It does not apply to other bankruptcy cases.[20] In all bankruptcy cases other than chapter 11, section 366(b) governs adequate assurance of payment.

For purposes of section 366(c), "assurance of payment" means a cash deposit, a letter of credit, a certificate of deposit, a surety bond, a prepayment of utility consumption, or other security "mutually agreed" upon by the utility and the debtor or trustee.[21] An administrative expense priority does not constitute assurance of payment.[22]

If a utility does not receive adequate assurance of payment that is "satisfactory to the utility" within 30 days of the commencement of a chapter 11 reorganization, then the utility may alter, refuse, or discontinue utility service.[23] Upon a party's request and after notice and a hearing, a court may modify the "amount" of the assurance of payment. It is unclear whether a court may modify the form of the assurance of payment.[24] In determining whether an assurance of payment is adequate, the court may not consider the absence of security before the case was commenced, timely payment of utility bills before the case was commenced, or the availability of an administrative expense priority.[25]

Further, "notwithstanding any other provision of law," and "without notice or order of the court," a utility may recover or set off against a security deposit provided by a chapter 11 debtor before the commencement of the chapter 11 case.[26]

Violation of Section 366

In most instances, section 366 is self-executing, similar to the section 362 automatic stay. Likewise, the consequences of violating section 366 are similar to the consequences of violating section 362. If a utility violates section 366, then it may be held in contempt and required to pay damages and attorney fees.[27]

Application of Section 366

In practice, large chapter 11 bankruptcy debtors or trustees often file a utilities motion upon or soon after commencing a case. The motions often request minimal assurance of payment. In addition, they often prohibit termination

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of utility service without a court order. Unless an affected utility replies or objects to the motion, participates in the hearing, or settles with the trustee or debtor regarding assurance of payment, courts usually grant the motions. Unfortunately, this practice continues in chapter 11 cases, despite the addition of section 366(c).

If a chapter 11 debtor or trustee provides a utility notice of a motion offering assurance of payment, and if the utility fails to reply, object, or offer different assurance of payment, then the utility's "silence" may be interpreted as acquiescence to, or acceptance of, the assurance of payment as satisfactory. The utility, however, may later request modification of the assurance of payment amount.[28]

Depending upon the amount of a debtor-member's utility bill, it may be wise for an electric cooperative to reply or object to the debtor's utility motion, participate in the hearing on the utility motion, or settle with the trustee or debtor.

As "other security" under section 366(b) or "another form of security" under section 366(c), an electric cooperative could seek an agreement from the trustee or debtor that, if the debtor-member fails to pay for service rendered after the commencement of the case, then the debtor-member agrees to an immediate and discounted retirement of capital credits to the extent needed to pay for the service.[29] The cooperative, however, may already have a right to set off or recoup capital credit retirements against amounts owed by the member.[30]

* * *

Practice Pointers

Gilbert L. Hamberg, a bankruptcy attorney with extensive experience representing electric cooperatives and other utilities in section 366 proceedings, offers the following *"Practice Pointers"* for electric cooperatives confronting commercial members filing for chapter 11 bankruptcy:

Security Deposit. *Always*, without exception before or after bankruptcy, try to have a security deposit, letter of credit, or surety bond equaling the number of days of financial risk in a monthly billing cycle. A security deposit is preferred. In most states, the typical security deposit is twice the highest monthly invoice, or twice the average monthly invoice. When a large, commercial member files for chapter 11 bankruptcy, many electric cooperatives realize they are completely unsecured for unpaid, pre-petition invoices. Because many cooperatives bill members every month, and provide many days to pay, their typical financial risk equals or exceeds 60 days. The security deposit should be maintained for the entire time the account is active. If a state law, tariff, rule, or regulation requires a cooperative to refund a security deposit to prompt paying members, then lobby to change the law.

Semi-monthly Invoices. Consider reducing the monthly billing cycle through semi-monthly invoices sent electronically on the 15th and 30th days. These invoices could require electronic payment within five days, and provide for electronic default notices and five-day cure periods. With semi-monthly invoices, an electric cooperative could reduce its security deposit to 25 days of charges. Innovative billing benefits the cooperative and its members. Once a member is accustomed to accelerated payment arrangements, the process can continue if it files for chapter 11.[31]

Escrow Accounts. While there were cases unsympathetic to utilities under section 366(b) before the addition of section 366(c),[32] there were also cases sympathetic to utilities.[33] Under section 366(c), the most common relief proposed by chapter 11 debtors is an escrow account held in the debtor's bank and funded with an amount equaling two weeks of average utility charges. An escrow account, however, is not a "cash deposit" as specified in section 366(c)(1)(A)(i).[34] Further, *only* the forms of payment specified in section 366(c)(1)(A) qualify as assurance of payment.[35]

Section 366(c) Motions and Cases. Many section 366(c) utility motions filed by chapter 11 debtors have been positive for utilities.[36] These motions proposed assurances of payment ranging from security deposits for five months or less of service, to payment of pre-petition charges, to advance payment arrangements. There are only a few published section 366(c) cases.[37] One case held that utilities which do not object or respond to a section 366(c) motion will be bound by the proposed relief.[38] Another case held that the utility was entitled to a one month, post-petition security deposit as assurance of payment.[39] Another case held that the proper construction of section 366(c) is that first, the debtor has to pay the utility what

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it requests as assurance of payment. Afterwards, a court may consider modification.[40] Another case held that section 366(c) does not apply to a chapter 12 case.[41]

Termination Injunction. In section 366 motions, debtors often seek to enjoin utilities from terminating for any reason post-petition, including non-payment of post-petition invoices, or while an objection or a request for additional assurance of payment is pending. This injunction could last beyond the 30-day period in section 366(c) prohibiting termination. Other than a few cases comprising the minority view,[42] the majority of cases hold that upon non-payment of a post-petition invoice, and after the section 366 injunction expires, a utility may terminate by complying with applicable state law termination procedures, and without obtaining prior bankruptcy court authorization. Further, bankruptcy courts lack jurisdiction over this issue.[43]

If you have comments or questions, please contact me at 703-907-5855 or tyrus.thompson@nreca.coop. Please feel free to contact Mr. Hamberg regarding his "*Practice Pointers*" at 215-321-6909 or ghamberg_3@msn.com.

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1 3 Alan N. Resnick & Henry J. Sommer, Collier on Bankruptcy ¶ 366.LH (15th ed. June 2006) [*hereinafter* "Collier on Bankruptcy"].

2 U.S.C. tit. 11.

3 Act of Nov. 6, 1978, Pub. L. No. 95-598 tit. 1, § 101, 92 Stat. 2549, 2578 (codified as 11 U.S.C. § 366).

4 S. Rep. No. 95-989, at 60 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5787, 5846 *and* H.R. Rep. No. 95-595, at 350 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6306.

5 3 Collier on Bankruptcy, *supra* ¶¶ 366.01 (June 2008), 366.LH (June 2006) *and* Hanratty v. Philadelphia Elec. Co. (*In re* Hanratty), 907 F.2d 1418 (3rd Cir. 1990).

6 3 Collier on Bankruptcy, *supra* ¶ 366.02 (June 2008); *See also* 11 U.S.C. §§ 362, 365.

7 *See* Mass. Elec. Co. v. Keydata Corp. (*In re* Keydata Corp.), 12 B.R. 156 (B.A.P. D. Mass. 1981) (*cited* in R.I. Hosp. Trust Nat'l Bank v. Elliott Leases Cars, Inc. (*In re* Elliott Leases Cars, Inc.), 20 B.R. 893 (Bankr. D. R.I. 1982); *In re* Utica Floor Maint., Inc., 25 B.R. 1010 (N.D. N.Y. 1982); *In re* Adelphia Bus. Solutions, 280 B.R. 63 (Bankr. S.D. N.Y. 2002); Marion Steel Co. v. Ohio Edison Co. (*In re* Marion Steel Co.), 35 B.R. 188 (Bankr. N.D. Ohio 1983); Steinebach v. Tucson Elec. Power Co. (*In re* Steinebach), 303 B.R. 634 (Bankr. D. Ariz. 2003); *and In re* Santa Clara Circuits West, Inc., 27 B.R. 680 (Bankr. D. Utah 1982); *See also In re* Circuit City Stores, Inc., No. 08-35653, 2009 Bankr. LEXIS 237, 2009 WL 484553, (Bankr. E.D. Va., Jan. 14, 2009); *In re* New Rochelle Tel. Corp., 397 B.R. 633 (Bankr. E.D. N.Y. 2008); *In re* Astle, 338 B.R. 855 (Bankr. D. Idaho 2006); *In re* Anchor Glass Container Corp., 342 B.R. 872 (Bankr. M.D. Fla. 2005); *and In re* George C. Frye Co., 7 B.R. 856 (Bankr. D. Me. 1980).

8 Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. No. 98-353, tit. III, subtit. H, § 443, 98 Stat. 333, 373 ("Section 366(a) of title 11 of the United States Code is amended by inserting 'of the commencement of a case under this title or' after 'basis.'").

9 Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, tit. IV, subtit. A, § 417, 119 Stat. 23, 108 (approved Apr. 20, 2005).

10 11 U.S.C. §§ 301, 366(a) (LEXIS through Pub. L. No. 111-15, approved April 24, 2009).

11 *See* 3 Collier on Bankruptcy, *supra* ¶ 366.05 (March 2008) a*nd In re* Gehrke, 57 B.R. 97 (Bankr. D. Ore. 1985).

12 3 Collier on Bankruptcy, *supra* ¶ 366.04 (March 2008). Courts disagree whether a utility may "discriminate" by requiring assurance of payment from a bankruptcy debtor who owes the utility no debt, while not requiring deposits from new customers who owe the utility no debt. Because section 366(c) prohibits a court from considering the timely payment of utility bills before a chapter 11 case was commenced, it seems to permit a utility to "discriminate" against chapter 11 debtors who owe a utility no debt. 3 Collier on Bankruptcy, *supra* ¶ 366.04 (March 2008) *and* Hanratty v. Philadelphia Elec. Co. (*In re* Hanratty), 907 F.2d 1418 (3rd Cir. 1990).

13 11 U.S.C. §§ 301, 366(b).

14 3 Collier on Bankruptcy, *supra* ¶ 366.03[1] (June 2008).

15 3 Collier on Bankruptcy, *supra* ¶¶ 366.03[1], 366.04 (June 2008); Begley v. Philadelphia Elec. Co., 760 F.2d 46 (3rd Cir. 1985); *and* Robinson v. Mich. Consol. Gas Co., 918 F.2d 579 (6th Cir. 1990).

16 In general, a utility is usually entitled to an administrative expense allowance for service rendered in the "ordinary course of business" that is "actual [and] necessary" for "preserving the [bankruptcy] estate." 11 U.S.C. §§ 364(a), 503(b)(1)(A); *See also* 3 Collier on Bankruptcy, *supra* ¶ 366.03[1] (June 2008) *and* 4 Collier on Bankruptcy, *supra* ¶ 503.06[5] (June 2000). Interestingly, the U.S. House of Representatives Committee on the Judiciary noted, "If an estate is sufficiently liquid, the guarantee of an administrative expense priority may constitute adequate assurance of payment for future services. It will not be necessary to have a deposit in every case." H.R. Rep. No. 95-595, at 350 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6306. It is unclear when an estate is "sufficiently liquid." While section 366(b) does not address whether an administrative expense allowance may constitute adequate assurance of payment, the addition of section 366(c)(1)(B) suggests a "negative implication" that it may for cases not subject to section 366(c). 3 Collier on Bankruptcy, *supra* ¶ 366.03[1] (June 2008).

17 *See* 3 Collier on Bankruptcy, *supra* ¶ 366.03[1] (June 2008) *and* Va. Elec. & Power Co. v. Caldor, Inc., 117 F.3d 646 (2nd Cir. 1997).

18 *See* 11 U.S.C. §§ 362(a)(7), 553(a); *In re* McMahon, 129 F.3d 93 (2nd Cir. 1997); *and* 3 Collier on Bankruptcy, *supra* ¶ 366.03[2] (March 2008).

19 Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, tit. XV, § 1501, 119 Stat. 23, 216 *and* 3 Collier on Bankruptcy, *supra* ch. 366, fn. 14 (March 2008).

20 3 Collier on Bankruptcy, *supra* ¶ 366.03[2] (March 2008) *and In re* Astle, 338 B.R. 855 (Bankr. D. Idaho 2006).

21 11 U.S.C. § 366(c)(1)(A).

22 11 U.S.C. § 366(c)(1)(B).

23 11 U.S.C. § 366(c)(2).

24 11 U.S.C. § 366(c)(3)(A) *and* 3 Collier on Bankruptcy, *supra* ¶ 366.03[2] (March 2008).

25 11 U.S.C. § 366(c)(3)(B).

26 11 U.S.C. § 366(c)(4).

27 3 Collier on Bankruptcy, *supra* ¶ 366.06 (March 2008); *See also* 3 Collier on Bankruptcy, *supra* ¶ 366.03[1] (June 2008).

28 *See In re* Circuit City Stores, Inc., No. 08-35653, 2009 Bankr. LEXIS 237, 2009 WL 484553 (Bankr. E.D. Va. 2009); *In re* Beach House Prop., No. 08-11761-BKC-RAM, 2008 Bankr. LEXIS 1091, 2008 WL 961498 (Bankr. S.D. Fla. 2008); *and In re* Syroco, Inc., 374 B.R. 60 (Bankr. D. P.R. 2007); *But see In re* Lucre, Inc., 333 B.R. 151

(Bankr. W.D. Mich. 2005) (utility's failure to respond to debtor's assurance of payment offer is not utility's acceptance of offer as satisfactory).

[29] Before seeking this assurance of payment, the cooperative should adopt a policy requiring similar treatment under similar circumstances for all members, all members of a specific class, or all similarly situated members.

[30] *See* Capital Credits Task Force Report Legal Supplement 39-45 (Jan. 2005), *available at* https://www.cooperative.com/general/documents/CapitalCreditsTaskForce/CapitalCreditsLegalSup.pdf *and,* for Electric Cooperative Bar Association members, *at* https://co-opbar.cooperative.com/members/OnlineLibrary/CooperativeLaw/CapitalCreditsTask_ForceReportLegalSupplement.pdf.

[31] *See In re* Penn Cent. Transp. Co., 467 F.2d 100 (3rd Cir. 1972) *and In re* Monroe Well Serv., Inc., 69 B.R. 58 (E.D. Pa. 1986).

[32] *See In re* Caldor, Inc., 117 F.3d 646 (2nd Cir. 1997); *In re* Adelphia Bus. Sol., Inc., 280 B.R. 63 (Bankr. S.D. N.Y. 2002), *and* Pearl-Pit Gmt. Ltd v. Caldor Co., 266 B.R. 575 (S.D. N.Y. 2001) (addressing insolvency of Caldor).

[33] *See In re* Hanratty, 907 F.2d 1418 (3rd Cir. 1990); *In re* Norsal Indus., Inc., 147 B.R. 85 (Bankr. N.D. N.Y. 1992); *In re* Carter, 133 B.R. 110 (Bankr. N.D. Ohio 1991); *In re* Cole, 104 B.R. 736 (Bankr. D. Md. 1989); *In re* Lloyd, 52 B.R. 653 (Bankr. S.D. Ohio 1985); *and In re* Smith, Richardson & Conroy, Inc., 50 B.R. 5 (Bankr. S.D. Fl. 1985).

[34] *See* Black's Law Dictionary 471 (8th ed. 2004) (defining "deposit").

[35] *In re* New Rochelle Tel. Co., 397 B.R. 633, 639 (Bankr. E.D. N.Y. 2008); *In re* Astle, 338 B.R. 855, n. 13, 860 (Bankr. D. Idaho 2006); *and In re* Lucre, Inc., 333 B.R. 151, 153-154 (Bankr. W.D. Mich. 2005).

[36] *See* Gilbert L. Hamberg, *Sample of Section 366(c), Debtor-Filed Utilities Motions*, available to LRS subscribers at www.cooperative.com/lrs (June 2009 LRS Appendix).

[37] *See* Gilbert L. Hamberg, *Published, Section 366 Decisions: October 17, 2005 to Current*, available to LRS subscribers at www.cooperative.com/lrs (June 2009 LRS Appendix).

[38] *In re* Syroco, Inc., 374 B.R. 60 (Bankr. D. P.R. 2007).

[39] *In re* New Rochelle Tel. Co., 397 B.R. 633 (Bankr. E.D. N.Y.2008).

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

[41] *In re* Astle, 338 B.R. 855 (Bankr. D. Idaho 2006).

[42] *See In re* Caldor, Inc., 117 F.3d 646 (2nd Cir. 1997); *In re* Steinbach, 303 B.R. 634 (Bankr. D. Ariz. 2004); *and* 3 Collier on Bankruptcy ¶ 366.03[1] (2008) (noting prospective overruling of *In re* Caldor, Inc. by enactment of section 366(c)).

[43] *See* Robinson v. Mich. Con. Gas Co., 918 F. 2d 579 (6th Cir. 1990); Begley v. Philadelphia Elec. Co., 760 F.2d 46 (3rd Cir. 1985); *In re* Conxus Commun., Inc., 262 B.R. 893 (D. Del. 2001); *In re* Jones, 369 B.R. 745 (1st Cir. BAP 2007); *In re* Farley, 135 B.R. 292 (W.D. Tenn. 1991); Johnson v Philadelphia Elec. Co., 80 B.R. 30 (E.D. Pa. 1987); *In re* Weisel, 400 B.R. 457 (Bankr. W.D. Pa. 2009); *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); *In re* Best Prod. Co., 203 B.R. 51 (Bankr. E.D. Va. 1996); *and In re* Am. Investcorp & Dev. Co., 155 B.R. 300 (Bankr. D. R.I. 1993).

Recent Decisions

Commission Ruling Allowing Utility to Recover Costs of Planned Coal Plant in Its Rates Stands

Virginia supreme court finds no commerce clause violation in requirement that plant "utilize Virginia coal" – *Constitutional; State Utility Commission*

A number of environmental groups challenged an order by the Virginia State Corporation Commission (Commission) that permitted Virginia Electric Power Company (Utility) to recover in its rates the costs associated with constructing a new coal-fired power plant. The groups argued that the statute under which the Commission approved Utility's proposed rate recovery was unconstitutional because it violated the Commerce Clause of the U.S. Constitution. The Supreme Court of Virginia (Court) upheld the Commission, saying that the statute's provision to allow rate recovery for a facility "that utilizes Virginia coal" did not prohibit the use of coal from other states and did not discriminate against out-of-state coal producers in favor of Virginia suppliers. **Appalachian Voices v. State Corp. Comm'n, 675 S.E.2d 458 (Va. 2009).**

In 2007, Utility applied to the Commission for a rate adjustment to cover approximately $1.62 billion associated with constructing a proposed 585 megawatt coal plant in Wise County, Virginia. The plant was to incorporate clean coal technology and be compatible for future installation of carbon capture equipment. Various environmental groups, including Appalachian Voices (Environmentalists), participated in the Commission's public hearing and post-hearing briefing process. After considering the record before it, the Commission approved Utility's rate application and rejected the Environmentalists' arguments that the application was being premised on a statute that violated the dormant Commerce Clause. Environmentalists then brought this appeal.

At issue was Virginia Code § 56-585.1(A)(6) (Code), which states in relevant part:

> To ensure a reliable and adequate supply of electricity, to meet the utility's projected native load obligations and to promote economic development, a utility may at any time, after the expiration or termination of capped rates, petition the Commission for approval of a rate adjustment clause for recovery on a timely and current basis from customers of the costs of (i) a **coal-fueled generation facility that utilizes Virginia coal** and is located in

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the coalfield region of the Commonwealth . . . . (Emphasis added).

Environmentalists argued that this statute "unquestionably discriminates in favor of 'Virginia coal' at the expense of out-of-state coal" and, therefore, is facially discriminatory and unconstitutional. They relied upon three U.S. Supreme Court cases addressing the Commerce Clause. In Philadelphia v. New Jersey, a New Jersey statute that prohibited the importation of most solid or liquid waste from outside the state was struck down. In Wyoming v. Oklahoma, the U.S. Supreme Court ruled that an Oklahoma statute requiring coal-fired electric utilities to use at least ten percent Oklahoma-mined coal discriminated against interstate commerce and was, therefore, unconstitutional. In Granholm v. Heald, Michigan and New York laws, which prohibited out-of-state wineries from shipping directly to in-state consumers, but permitted such shipping by in-state wineries, were held to violate the Commerce Clause by discriminating against interstate commerce.

The Court held that unlike the statutes at issue in the three U.S. Supreme Court cases, the Code did not implicate interstate commerce. "Simply stated, the statute in question does not require – and the Commission did not order – that any amount of Virginia coal be used in the proposed coal-fired plant," the Court said. Instead, the Court explained the Code requires that the technology employed at the plant be able to burn Virginia coal. Further, other Virginia statutes require the plant to utilize the most economical coal or other resources, regardless of their source, to minimize fuel costs. There was no prohibition on importation of out-of-state coal as in the New Jersey waste statute; there was no prescription on the use of out-of-state coal as in the Oklahoma statute; and there was no scheme to favor in-state suppliers as in the Michigan and New York statutes.

The Court also held that even if the Code were unconstitutional, the Code was subject to a savings clause that would allow the "utilizes Virginia coal" language to be severed and the remainder of the Code upheld. Because the Environmentalists' other claimed errors were predicated on a successful Constitutional challenge, these errors could not be sustained.

The Commission's order is affirmed.

EDITOR'S NOTE: *While this decision was a victory for Utility, it also faces a challenge later this summer regarding the state air pollution control board's issuance of a permit for the plant. If you have questions or comments, please contact Tracey Steiner, NRECA Senior Corporate Counsel, at tracey.steiner@nreca.coop or 703-907-5847.*

Utility Indemnified for Pole Attachment Mishap

Mississippi appeals court holds that pole attachment agreement required indemnification for negligence action brought against utility – *Telecommunications; Utility*

TCA Cable Partners d/b/a Cox Communications (Cable Company) entered into an agreement with Entergy Mississippi, Inc. (Utility) to install television cables on its utility poles. Troy P. Cremeen (Resident) suffered serious injuries after walking into a television cable negligently strung between two Utility poles on his property. Resident brought a negligence action against Utility and Cable Company. Utility brought a cross claim for indemnification against Cable Company. The trial court granted Cable Company's motion for summary judgment on Utility's cross claim. Utility appealed to the Court of Appeals of Mississippi (Court), which reversed. **Entergy Miss., Inc. v. TCA Cable Partners, No. 2006-CA-01258-COA, 2009 Miss. App. LEXIS 201, 2009 WL 987400 (Miss. Ct. App. 2009).**

On appeal, Utility argued the trial court failed to consider Cable Company's obligation to indemnify and defend Utility under the parties' pole attachment agreement. The Court agreed, finding the agreement provided that Cable Company "shall indemnify, protect and save harmless [Utility] from and against any and all claims and demands for damages . . . which may arise out of or be caused by the erection, maintenance, presence, use or removal of said attachments . . . . " Further, the Court held an obligation to defend Utility arose under a separate provision of the agreement requiring Cable Company to provide insurance.

Judgment reversed and rendered.

EDITOR'S NOTE: *A dissenting opinion argued the case should have been reversed and remanded for further proceedings as Utility had not yet proved it was entitled to judgment as a matter of law against Cable Company. If you have any questions or comments, please contact Dave Predmore, NRECA Corporate Counsel, at 703-907-5848 or dave.predmore@nreca.coop.*

Coverage Found Under Insurance Policy for Losses Resulting From Blackout

New Jersey court concludes insurer's policy language was ambiguous on exclusion of coverage for a blackout – *Insurance; Miscellaneous*

In the August 2003 blackout that affected an estimated 50 million people in the northeastern United States and eastern Canada, a grocery store cooperative and nine of its members suffered losses due to food spoilage and lost business. The stores' insurance company denied coverage on the basis that the stores' policy only covered losses resulting from "physical damage" to off-premises electrical plant and equipment and there was no such physical damage to such equipment related to the blackout. The stores appealed after a trial court granted summary judgment for the insurance company. **Wakefern Food Corp. v. Liberty Mutual Fire Insurance Co., 968 A.2d 724 (N. J. Sup. Ct. App. Div. 2009).**

Wakefern Food Corporation, a retailer-owned cooperative (Wakefern), and nine of its 43 members own and operate ShopRite grocery stores in five northeastern states (collectively, Grocery Stores) that were affected by the electrical blackout in the Eastern Interconnection in August 2003. The Grocery Stores had jointly purchased a first-party, all-risk insurance policy at a $5.5 million premium from Liberty Mutual Fire Insurance Company d/b/a Liberty Mutual (Insurer). In addition to the standard policy, the Grocery Stores purchased a "Services Away from Covered Location Coverage Extension" (Extension) to cover, among other things, damages due to an interruption of electrical power to Grocery Stores' supermarkets. Insurer asserted that while the power grid was physically incapable of delivering power during the blackout, it had not suffered "physical damage" under the Extension. The term "physical damage" was not defined.

Both parties relied upon the final report submitted by a task force formed by the United States and Canada to investigate the blackout (Report) in their arguments. Insurer's expert opined that the outage primarily resulted from the operation of the relays attempting to prevent damage to electrical plant and equipment, echoing the conclusions in the Report. While noting that certain protective systems and devices were physically damaged when they operated to disconnect the equipment, this damage was not relevant because "certain systems . . . are designed to fail." Insurer also asserted that the Grocery Stores had not produced evidence of any physical damage to any of the specific types of property listed in the Extension, namely, transmission lines, connections, or supply pipes furnishing electricity to a covered location.

The Grocery Stores' expert opined that the blackout resulted from, in part, physical damage to generators and transmission equipment at sites away from the supermarkets, which damage was "a substantial factor" that caused, contributed to, or increased the scope and duration of the outage. He also opined that the grid "was physically damaged in that various components were rendered inoperable or were disconnected . . . and needed to be reconnected and restored."

The trial court sided with Insurer and granted Insurer's motion for summary judgment on the basis that there was no "physical damage" because the electrical system could be returned to service after the interruption, and the grid's safety features shut down equipment to keep it from being damaged. Grocery Stores appealed to the Superior Court of New Jersey, Appellate Division (Court).

The Court explained the "well-established" principles of construction for insurance policies: (1) where policy language supports two reasonable meanings, one favoring coverage and one not, interpretation supporting coverage is applied; (2) where an insurer claims a matter falls within a policy exclusion, the insurer has the burden of establishing that claim; (3) coverage clauses are construed liberally and exclusions strictly; (4) the court will look to the "common intent" of parties to a contract "to find a reasonable meaning in keeping with the express general purposes" of a policy; and (5) insurance contracts are interpreted to effectuate the reasonable expectations of the insured. The Court further noted that these principles apply to commercial entities, as well as individuals, when the insured did not participate in the drafting, as was the case here.

The Court concluded that the undefined term "physical damage" was ambiguous and the trial court erred in construing the term too narrowly, in favor of the Insurer, and inconsistently with the reasonable expectations of the insured Grocery Stores. The Court noted that the parties "were not two electric utilities contracting about the technical aspects of the grid" but rather an insurance provider and a "group of supermarkets that paid for what they believed was protection against a very serious risk – the loss of electric power to refrigerate their food." The Court further noted that an average insured "would not be expected to understand the arcane functioning of

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the power grid, or the narrowly-parsed definition of 'physical damage' which the insurer urges us to adopt." The Court, therefore, concluded that if Insurer intended that the Exclusion would exclude coverage for a blackout, "it was obligated to define its policy exclusion more clearly."

The Court said that based on the Report, "one could certainly argue that the system was not physically damaged." The Report was not written to help construe insurance policies, but to serve as an "operational analysis for the purpose of determining how the blackout occurred, who was at fault, and how future blackouts could be avoided." The perspective of the consumers affected by the blackout was that the grid was "physically damaged," the Court said, thus showing there were at least two different, reasonable interpretations for "physical damage."

The Court then cited precedent demonstrating that ambiguous provisions for "physical loss" or "physical damage" can include a loss of use, functionality, or access and that nothing in the Extension required the damage of the power equipment to be permanent. Therefore, the trial court erred in concluding that "physical damage" cannot include a temporary loss of power due to a power outage where the property could resume its former use or function as soon as power was restored. The Court rejected the cases cited by Insurer as "misplaced" and "distinguishable based on the difference in policy language."

The Court, therefore, concluded that the trial court erred in granting summary judgment for Insurer and that the Grocery Stores were entitled to summary judgment. Reversed and remanded.

EDITOR'S NOTE: *If you have questions or comments, please contact Tracey Steiner, NRECA Senior Corporate Counsel, at 703-907-5847 or tracey.steiner@nreca.coop.*

Linemen's Knowledge Not Imputed to Employer

U.S. appeals court holds that improper jury instructions regarding a corporation's knowledge of the existence of energized "static" transmission lines did not meet the harmless error standard – *Civil Procedure; Utility*

L.E. Meyers Company (Contractor) was indicted for willfully violating various Occupational Safety and Health Administration (OSHA) safety standards, resulting in the separate electrocution deaths of two of Contractor's linemen. At trial, the government presented a history of incidents as evidence that Contractor knowingly and willfully disregarded the hazards presented by energized "static" lines. Contractor was found guilty of the death of one of the linemen. The district court affirmed, holding the jury instructions erroneous, but harmless. On appeal, the U.S. Court of Appeals for the 7th Circuit (Court) reversed. **United States v. L.E. Myers Co., 562 F.3d 845 (7th Cir. 2009).**

On appeal, Contractor reiterated its claims that the jury instructions regarding "corporate knowledge" and "ostrich" instructions were erroneous and misleading. In U.S. v. Ladish Malting Co., 135 F.3d 484 (7th Cir. 1998), this Court held that "[c]orporations 'know' what their employees who are responsible for an aspect of the business know." Here, the jury instructions missed the material point of Ladish. The proper inquiry was not whether employees who acquire knowledge of a hazard were acting within the scope of employment, but whether those employees had a duty to report or ameliorate the hazard. Here, the "corporate knowledge" instruction informed the jury it could find a willful violation if any of Contractor's employees were aware or deliberately indifferent to the hazards posed by the energized static wires.

Next, the Court agreed that the "conscious avoidance" or "ostrich" instruction was improperly given to the jury. The Court explained that the instruction is only appropriate where the defendant deliberately acts to avoid learning the truth. While there is evidence of Contractor's deliberate indifference in this case, there is no evidence of deliberate avoidance. The harmless error standard requires the establishment, beyond a reasonable doubt, that the jury would have convicted absent the errors. Here, the cumulative effects of two instructional errors, the Court explained, significantly "watered down" the willfulness component of the offense and therefore, cannot be considered harmless.

Judgment reversed and remanded.

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