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## Is the Spark Gone?

### Another Court Holds That Electricity Is Ineligible for Priority Status Under Section 503(b)(9) of the Bankruptcy Code



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Section 503(b)(9) of the Bankruptcy Code gives a massive boost to creditors that sold goods to a financially distressed customer shortly before the customer's bankruptcy filing. While claims for goods sold before a bankruptcy filing are typically treated as general unsecured claims that often receive pennies on the dollar (or less!) in bankruptcy, section 503(b)(9) grants administrative expense priority to claims for goods sold and delivered during the 20 days before the bankruptcy filing—significantly increasing the likelihood of full payment of such claims.

Since the section 503(b)(9) priority only applies to the sale of goods and not the provision of services, litigation often ensues as to whether a particular product is, in fact, a "good." A frequently litigated issue is whether electricity is a good or a service for purposes of section 503(b)(9). Historically, courts have been roughly evenly split on the issue.

However, recent buzz on the issue has stung utilities and other electricity suppliers. As reported in the May 2023 edition of *Business Credit*, in February 2023, the U.S. District Court for the District of Oregon ruled that electricity is not a "good" and therefore cannot give rise to section 503(b)(9) priority. Only three months later, in the Chapter 11 cases of *Sears Holding Corporation*, the U.S. Bankruptcy Court for the Southern District of New York also denied priority status under section 503(b)(9) for a utility's claim for the supply of electricity on the basis that electricity is not a good. This latest decision from the Southern District of New York may mark the beginning of a trend against allowing priority status for claims arising from the supply of electricity—or perhaps it is just one bankruptcy court simply following precedent from its own district.

#### Background Regarding 503(b)(9) Claims

Section 503(b)(9) grants an administrative expense priority claim for:

"...the value of any goods received by the debtor within 20 days before the date of commencement of a case under this title in which the goods have been sold to the debtor in the ordinary course of such debtor's business."

Section 503(b)(9) provides a significant advantage to trade creditors that sold goods in the ordinary course of business on credit terms to a financially distressed customer that received the goods within 20 days before the customer filed bankruptcy. Section 503(b)(9) elevates what would otherwise be a prepetition general unsecured claim at the bottom of the Bankruptcy Code's claims priority ladder to an administrative expense priority claim, which is near the top of the Bankruptcy Code's priority ladder and generally must be paid in full for the debtor to confirm a Chapter 11 plan. As a result, section 503(b)(9) significantly increases the likelihood of a full recovery on claims for goods sold to and received by the debtor in the 20 days before the debtor's bankruptcy filing. But, importantly, this statutory priority only applies to claims arising from the sale of *goods*.

#### The Judicial Divide Over Whether Electricity Is a Good

The Bankruptcy Code does not define the term, "goods." So, courts tasked with interpreting section 503(b)(9) have generally applied 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."

**While bankruptcy courts agree that the UCC's definition of "goods" governs whether an item is a "good" for purposes of granting priority status under section 503(b)(9), the courts do not agree as to whether electricity meets the UCC's definition.**

**One group of courts has held that electricity satisfies the UCC's definition of goods and is eligible for section 503(b)(9) priority status because electricity is identified to the contract when the electricity passes through a meter—and is still moving (and is, therefore, "movable").** This group includes courts in Massachusetts (in *In re Erving Industries, Inc.*), Wisconsin (in *GFI Wisconsin, Inc. f/k/a Grede Foundries Inc. v. Reedsburg Utility Commission*); Montana (in *In re Southern Montana Electric Generation and Transmission Cooperative, Inc.*); and Colorado (in *In re Escalera Res. Co.*). In the *Sears* cases, the Utility noted

the United States Bankruptcy Court for the District of Puerto Rico has consistently granted section 503(b)(9) priority status to claims arising from the sale of electricity (in *In re Wometco de P.R., Inc.*, *In re PMC Marketing Corp.*, *In re Inversiones Araxi Group Corp.*, and *In re Gonzalez San Pedro*).

**Other courts have held that electricity does not satisfy the UCC's definition of goods because electricity is identified and measured by the meter after the end user had consumed the electricity—after the electricity stopped moving.** Courts in districts with some of the more historically active commercial bankruptcy dockets in the country, such as the District of Delaware (in *In re NE Opco, Inc.*) and the Southern District of New York (in the A&P case, *In re Great Atl. & Pac. Tea Co.*), where the *Sears* Chapter 11 cases are pending, have ruled that electricity is not a good and, as such, a claim for the provision of electricity is not entitled to section 503(b)(9) priority status. Other courts have also ruled that electricity is not a good, such as the Northern District of Texas (in *In re Pilgrim's Pride Corp.*) and the Eastern District of Kentucky (in *In re Samaritan Alliance, LLC*). Earlier this year, the U.S. District Court in Oregon reached the same conclusion in the NORPAC case, *In re North Pacific Cannery & Packers, Inc., et al.* (NORPAC).

## Background Regarding the *Sears* Decision

The Debtors—Sears Holdings Corporation, Kmart Corporation, and certain of their affiliates—filed Chapter 11 bankruptcy petitions on October 15, 2018. Roughly one year later, a utility, the Puerto Rico Electric Power Authority (PREPA) filed proofs of claim in the Chapter 11 cases for outstanding amounts owed to PREPA on account of electricity supplied to over 20 Kmart locations and nearly 20 *Sears* locations throughout Puerto Rico. PREPA's claims included an approximately \$530,000 priority claim under section 503(b)(9) for the electricity supplied during the 20 days before the Debtors' bankruptcy filing.

The Debtors objected to PREPA's proofs of claim, seeking to reclassify PREPA's asserted section 503(b)(9) priority claim as a general unsecured (non-priority) claim. The Debtors relied on the precedent from the Southern District of New York (the same

district in which the *Sears* bankruptcy cases were filed) in the *A&P* case that denied section 503(b)(9) priority status to a claim for the provision of electricity because electricity does not satisfy the UCC's definition of "goods."

In response, PREPA argued that the Bankruptcy Court should follow the contrary holdings that electricity is a "good" for purposes of section 503(b)(9). In particular, PREPA argued that the Bankruptcy Court should apply Puerto Rico law to determine whether PREPA was entitled to a section 503(b)(9) priority claim for the electricity supplied since the electricity was generated, supplied, consumed, and metered in Puerto Rico. Electricity is considered a "good" under Puerto Rico law and the U.S. Bankruptcy Court for the District of Puerto Rico has consistently granted administrative expense priority under section 503(b)(9) to electricity supplied by PREPA based on the UCC's definition of "goods."

## The Bankruptcy Court's Decision

The Bankruptcy Court held that electricity is not a "good" and, therefore, a claim relating to the provision of electricity to a debtor is not entitled to priority status under section 503(b)(9). The Bankruptcy Court rejected PREPA's argument that Puerto Rico law applies because federal law, the United States Bankruptcy Code, applies. The Bankruptcy Court noted that looking to state law to address section 503(b)(9) claims would produce "absurd results" since "[d]ebtors with multi-state footprints could face different priorities for the same claim by the same provider, simply because the electricity was delivered in different jurisdictions."

Like other courts that have addressed this issue, the Bankruptcy Court applied the UCC's definition of "goods" since Congress did not provide any guidance over what constitutes a "good" in interpreting section 503(b)(9). The court noted that adopting the UCC's definition satisfies one of the core principles of federal bankruptcy law: ensuring the uniform treatment of creditors in bankruptcy. While several courts outside of the Southern District of New York have held that electricity satisfies the UCC's definition of goods, the Bankruptcy

Court relied on prior Southern District of New York court holdings (most recently in the *A&P* case) that electricity is not a good according to the UCC's definition and any claim for the supply of electricity is not eligible for priority status under section 503(b)(9).

The Bankruptcy Court also noted that even outside of the bankruptcy context, courts are divided as to whether electricity satisfies the UCC's definition of goods. The court observed that most of the state courts that have applied the UCC's definition of goods to electricity have held that electricity is a service while in transmission but is a good once metered and identifiable. The Bankruptcy Court concluded that non-bankruptcy case law does not provide any useful guidance in determining whether electricity is a good or a service.

## Conclusion

The Bankruptcy Court's holding in the *Sears* cases is a disappointment to utilities and other electricity suppliers as it is yet another decision limiting the applicability of priority status section 503(b)(9). However, creditors may take solace in that the *Sears* decision seemed to be largely reliant on the prior precedent from the Southern District of New York. While the court cited the various decisions outside of the Southern District of New York that also held electricity cannot give rise to a section 503(b)(9) priority claim—including the February 2023 decision in *NORPAC*—the *Sears* decision was largely focused on rejecting PREPA's choice-of-law-based arguments rather than on dissecting the split in authority over whether electricity meets the UCC's definition of "goods."

No appeal was taken from either the *Sears* or *NORPAC* rulings, so any judicial scrutiny of these decisions will have to come from another case. It remains to be seen what impact the *Sears* decision may have outside of the Southern District of New York. ■■■■

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