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## Code to Code

BY IAN J. BAMBRICK

### Electricity Under *Escalera*

#### The Expanding Definition of "Goods" Under § 503(b)(9)



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Should the heat from a fire or the sound from a musical instrument qualify as a "good" and therefore be entitled to administrative priority status under § 503(b)(9) of the Bankruptcy Code? How about an ocean current or a strong wind? Although holding these things to be "goods" seems absurd, they are intrinsically no different than electricity in that they are examples of different forms of energy. Yet, even though we would not consider these other forms of energy to be "goods," a number of bankruptcy courts, including most recently the U.S. Bankruptcy Court for the District of Colorado in *In re Escalera Res. Co.*,<sup>1</sup> have held that electricity should qualify as a "good" for purposes of § 503(b)(9). In addition, in holding that electricity qualifies as a "good," the *Escalera* court adopted an interpretation of "goods" that includes not just electricity, but also forms of energy like those mentioned above.

#### Section 503(b)(9) and Pre-*Escalera* Case Law

Section 503(b)(9) provides that "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 had been sold to the debtor in the ordinary course of such debtor's business" is entitled to administrative expense priority.<sup>2</sup> At first blush, this seems like a pretty straightforward provision. Yet bankruptcy courts have struggled with this provision when it comes to one "thing" in particular: electricity. Why is electricity so troublesome? There are two main reasons: (1) the Bankruptcy Code fails to provide a definition of the term "goods," and (2) although electricity is a familiar phenomenon, it is a complex one that is not well understood. Turning to the first issue,

because the Bankruptcy Code does not define the term "goods," bankruptcy courts addressing whether electricity qualifies as a "good" have uniformly turned to the Uniform Commercial Code (UCC),<sup>3</sup> which defines "goods" as "all things (including specially manufactured goods) [that] are movable at the time of identification."<sup>4</sup>

On the one hand, the bankruptcy courts that have held that electricity qualifies as a "good" have found that it is (1) a thing because it is tangible, (2) moveable because it travels through an electrical grid to where it is ultimately used, and (3) identifiable because it can be measured by an electromechanical meter.<sup>5</sup> On the other hand, those that have held that electricity does not qualify as a "good" have mainly taken issue with the third requirement: holding that electricity does not meet the identifiability requirement for one reason or another.<sup>6</sup> For example, in *NE Opco*, the U.S. Bankruptcy Court for the District of Delaware found that "in order to do justice to the term [good] as it has developed over 1,000 years, the period between identification and consumption must be meaningful." In light of this, the court held that electricity does not qualify

3 *In re Samaritan All. LLC*, 2008 WL 2520107, at \*4 (Bankr. E.D. Ky. June 28, 2008); *In re Pilgrim's Pride Corp.*, 421 B.R. 231, 240 (Bankr. N.D. Tex. 2009); *In re Erving Indus. Inc.*, 432 B.R. 354, 368 (Bankr. D. Mass. 2010); *In re Grede Foundries Inc.*, 435 B.R. 593, 595 (Bankr. W.D. Wis. 2010), *aff'd sub nom.*, *GFI Wis. Inc. v. Reedsburg Util. Comm'n (In re Grede Foundries Inc.)*, 440 B.R. 791, 799 (W.D. Wis. 2010); *In re S. Mont. Elec. Generation and Transmission Coop. Inc.*, 2013 WL 85162, at \*5 (Bankr. D. Mont. Jan. 8, 2013); *NE Opco*, 501 B.R. 233, 256 (Bankr. D. Del. 2013); *Hudson Energy Serv. LLC v. Great Atl. & Pac. Tea Co. Inc. (In re Great Atl. & Pac. Tea Co. Inc.)*, 538 B.R. 666, 669 (S.D.N.Y. 2015); and *In re Wometco de P.R. Inc.*, 2016 WL 155393, at \*2 (Bankr. D.P.R. Jan. 12, 2016).

4 U.C.C. § 2-105 (2016).

5 *In re Erving Indus. Inc.*, 432 B.R. at 369-70; *In re Grede Foundries Inc.*, 435 B.R. at 595-96; *In re Wometco de P.R. Inc.*, 2016 WL 155393, \*2; and *In re S. Mont. Elec. Generation and Transmission Coop. Inc.*, 2013 WL 85162, \*5.

6 501 B.R. at 250; see also *In re Pilgrim's Pride*, 421 B.R. at 239 (holding that electricity did not qualify as a good because "[o]nce electricity has been 'identified' by measurement at the meter, it has already been consumed by the end user," and this identification is insufficient because U.C.C. "§ 2-105 does not suggest that the provision's drafters had intended that 'goods' would include things which cannot be packaged and handled"); *Hudson Energy Servs.*, 538 B.R. at 673, (holding that "the electricity here is not movable at the time of identification because it has already been used" — *i.e.*, "identification occurs after consumption").

1 563 B.R. 336 (Bankr. D. Colo. 2017).

2 11 U.S.C. § 503(b)(9).

as a “good” because, given the speed at which the electromagnetic wave of electrical energy travels,<sup>7</sup> a “difference of approximately 1/60th of 1/60th of 1/60th of a second between identification and consumption renders the separation between the two meaningless.”<sup>8</sup> However, what is common among those cases that have held that electricity qualifies as a “good” and those that have held that it does not is a general lack of evidence regarding the nature of electricity, which implicates the second issue: Electricity is a not-well-understood, complex phenomenon. It is into this conflicted and evidentiarily questionable quagmire that the bankruptcy court in Escalara waded.

## Escalara

In Escalara, the bankruptcy court thoroughly considered the nature of electricity based on the testimony of an expert witness in the field of physics. Based on this testimony, it adopted the term “electrical energy” because that phrase “is proper and best reflects the nature of the transaction between [the utility] and the Debtor.”<sup>9</sup>

After finding that electrical energy qualifies as a “good” under general definitions of the term (because it (1) “most definitely is a ‘thing’” based on the expert testimony that “electrical energy is the energy per electron multiplied by the total number of electrons carrying the charge,” (2) has value, (3) is a commodity because futures contracts for electrical energy are regulated by the Commodity Futures Trading Commission, and (4) is tangible as is evidenced by the fact that it can be seen, heard and felt),<sup>10</sup> the court adopted the UCC definition for “goods” as the “principal legal definition for purposes of” § 503(b)(9).<sup>11</sup> The court then characterized the UCC definition for “goods” as “(1) things existing and identifiable; (2) movable at the time of identification; and (3) capable of being sold.”<sup>12</sup> Ultimately, the court held that electrical energy satisfies the UCC definition because it “is a thing that exists, can be identified, and is capable of being sold,”<sup>13</sup> and is moveable given that a “meter records movement of electrical energy.”<sup>14</sup> The court then turned to federal antitrust law, federal labor law, federal energy regulatory law, state tort law, tax law and international treaties for additional support that electrical energy qualifies as a “good.”<sup>15</sup>

## The Nature of Electrical Energy and the Implications of Escalara

The Escalara court stated that the “main focus of the inquiry is on the plain meaning of the term ‘goods’”<sup>16</sup> while also stating that, “under a UCC analysis, the focus should be on the nature of electrical energy (including whether it is movable at the time of identification) rather than an arbitrary time interval.”<sup>17</sup> The issue is that given the breadth the court gives to the definition of “goods” and the physical nature of electrical energy, things that Congress almost assuredly did

not intend to qualify as “goods” would qualify as such based on Escalara’s reasoning.

Electrical energy is a form of energy, and energy is defined scientifically as the capacity of a physical system to perform work.<sup>18</sup> The capacity to do work<sup>19</sup> seems an odd fit for “goods” when the examples provided by the commentary to the UCC include the unborn young of animals, growing crops, wool crop, timber, minerals, and a structure and the materials that make up a structure,<sup>20</sup> all of which are material objects. As such, including in the definition of “goods” the capacity to do work seems counterintuitive and cuts against the Escalara court’s focus on the plain meaning of the term. This becomes even clearer when one considers some other forms of energy that would qualify as “goods” under Escalara’s reasoning.

For example, take the music from a jukebox. Sound is a form of energy, but given the broad reading of the UCC definition of “goods” provided by Escalara, the music from a jukebox would qualify as a “good” because (1) it is tangible in that one can hear it and, if it is loud enough, feel it, and, therefore, it is a thing; (2) it can be identified by a device called a sound level meter analogous to an electromechanical meter identifying electrical energy; (3) it is moveable at the time of identification in that it travels directionally and can be directed; and (4) it is sold when one purchases a song. Yet, it is a stretch to say that a song purchased from a jukebox qualifies as a “good” under the plain meaning of that term. Similarly, mechanical energy — for example, the power produced by an engine — would qualify as a “good” under the Escalara reasoning because it (1) is tangible in that one can hear it and feel it, therefore, it is a thing; (2) can be identified by a device called a dynamometer; (3) is moveable at the time of identification (i.e., it can travel along a path similar to electrical energy); and (4) is capable of being sold. That being the case, who would categorize a taxi ride as a “good” rather than a service? Even the counterargument that the driver’s skill is the key difference will shortly fall away as autonomous vehicles become commonplace.

## Conclusion

If broadly adopted, the Escalara court’s reasoning would lead to a large number of things that we do not think of as “goods” qualifying as such. So where should the line be drawn? Arguably, one could draw the line around electrical energy, holding that electrical energy is the only type of energy that qualifies as a “good.” However, such a distinction would be arbitrary and unsupported by the Bankruptcy Code or the UCC, as well as counter to the Escalara court’s

<sup>18</sup> *CRC Handbook of Chemistry and Physics*, p. 2-45 (David R. Lide, Ph.D., ed., 85th ed. 2004) (“energy” is defined as “characteristic of a system that enables it to do work”). Energy, *Oxford English Dictionary* (March 2016) (meaning 6), available at oed.com/viewdictionaryentry/Entry/62088 (log-in required; unless otherwise indicated, all links in this article were last visited May 1, 2017) (“The power of ‘doing work’ possessed at any instant by a body or system of bodies. First used by Young (with reference to sense 4) to denote what is now called actual, kinetic, or motive energy, i.e., the power of doing work possessed by a moving body by virtue of its motion[.] Now extended ... to include potential, static, or latent energy, or energy of position, i.e., the power of doing work possessed by a body in virtue of the stresses which result from its position relatively to other bodies. Also with adjs., mechanical energy, molecular energy, chemical energy, electrical energy, etc.; atomic energy[.]”).

<sup>19</sup> “Work” is defined as whenever a force results in displacement. *CRC Handbook of Chemistry and Physics*, p. 2-45 (David R. Lide, Ph.D., ed., 85th ed. 2004); Work, *OED* (March 2016) (meaning 10), available at oed.com/viewdictionaryentry/Entry/230216 (“The operation of a force in producing movement or other physical change, esp. as a measurable quantity; the result of a force operating through a distance; energy transferred from one system to another that causes changes in the macroscopic properties of the latter (such as volume, height, or speed).”).

<sup>20</sup> U.C.C. § 2-105 (2016), § 2-105 cmt. (2016) and § 2-107 (2016).

<sup>7</sup> *Id.*  
<sup>8</sup> *Id.* at 251.  
<sup>9</sup> 563 B.R. at 344.  
<sup>10</sup> *Id.* at 349.  
<sup>11</sup> *Id.* at 350.  
<sup>12</sup> *Id.* at 358.  
<sup>13</sup> *Id.* at 359.  
<sup>14</sup> *Id.* at 360.  
<sup>15</sup> *Id.* at 360-69.  
<sup>16</sup> *Id.* at 339 (emphasis added).  
<sup>17</sup> *Id.* at 358.

appropriate focus on the “plain meaning” of “goods” and “nature of electrical energy.” Instead, given the established policy that Bankruptcy Code “provisions allowing preferences must be tightly construed,”<sup>21</sup> it would be more logical to hold that electrical energy and all other forms of energy do not qualify as “goods” because they are, in essence, the capacity to perform work rather than what we generally consider to be “goods” (i.e., material objects).<sup>22</sup>

As the court in *Hudson Energy Services* held, “where it is ‘far from clear’ that a claim falls within the Bankruptcy Code’s priority provisions, courts should ‘reject [an] expanded interpretation ... [u]nless and until Congress otherwise directs.’”<sup>23</sup> In light of the fact that electrical energy is a form of energy rather than a material object, it is fair to say that it is far from clear whether Congress intended electrical energy to qualify as a “good” under § 503(b)(9) of the Bankruptcy Code. In light of this, it would be better to exclude electrical energy from the term “goods” until Congress provides additional clarity than to include it and significantly broaden the term, thereby capturing things that Congress almost assuredly did not want to qualify as “goods.” For this reason, those courts, such as the Delaware Bankruptcy Court, that have held that electrical energy does not qualify as a “good” due to issues with identifiability reached the correct result, albeit on different grounds.<sup>24</sup> **abi**

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<sup>21</sup> *Howard Delivery Serv. v. Zurich Am. Ins. Co.*, 547 U.S. 651, 667 (2006) (citing *Kothe v. R.C. Taylor Trust*, 280 U.S. 224, 227 (1930) (“The broad purpose of the Bankruptcy Act is to bring about an equitable distribution of the bankrupt’s estate.”)).

<sup>22</sup> The court argues that there is no ambiguity to the use of the term “goods.” This is despite the fact that the term “appears as part of a single sentence subsection in a statute governing the ‘allowance of administrative expenses,’” *Escalara* at 346, and there is clearly no consensus among bankruptcy courts as to whether electrical energy qualifies as a “good.” Given those facts, the court’s position that the term is unambiguous seems inapt.

<sup>23</sup> *Hudson Energy*, 538 B.R. at 673 (citing *Howard Delivery Serv.*, 547 U.S. at 667).

<sup>24</sup> The nature of electrical energy is a threshold issue in determining whether electrical energy qualifies as a “good.” However, even if this were not the case, this author agrees with those courts that hold that electrical energy does not qualify as a “good” on the grounds that there is an issue with identifiability. Specifically, being measurable does not necessarily equate to being identifiable. However, a discussion of that aspect of the issue is beyond the scope of this article.