# ARTICLES

## SUSTAINING POWER: APPLYING 11 U.S.C. § 366 IN CHAPTER 11 POST-BAPCPA

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### INTRODUCTION

The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 ("BAPCPA")[1] appears on its face to have struck a significant blow to chapter 11 debtors. Although BAPCPA has created quite a controversy over its consumer debtor provisions, the possibility of business debtors achieving successful rehabilitation could also be in jeopardy. Specifically, certain amendments to the U.S. Bankruptcy Code ("Bankruptcy Code")[2] cut at the most fundamental of business needs—utility services.

Section 366 of the Bankruptcy Code was originally intended to protect the chapter 11 debtor's access to utility services and thereby provide the debtor with a realistic chance at rehabilitation.[3] In exchange, the utility service provider was entitled to adequate assurance of payment to protect its legitimate business interest in receiving payment for the services it provided.[4] To further the underlying purpose of § 366, bankruptcy courts considered the particular facts of each case when determining the amount or type of assurance that was adequate and applied § 366 with a focus on balancing the interests of the debtor and utility service provider.[5]

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1 Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, 119 Stat. 23.

2 The Bankruptcy Code is title 11 of the U.S. Code. All statutory references are to title 11 unless otherwise specified.

3 11 U.S.C.S. § 366 (2006); *see infra* Part I.

4 *See* 11 U.S.C.S. § 366.

5 *See infra* notes 45–49.

On the surface, BAPCPA shifted that balance. The new § 366(c) provides the chapter 11 debtor must produce assurance of payment "satisfactory to the utility."[6] This provision appears to vest the utility provider with total discretion, effectively permitting the utility to terminate the debtor's service—and rehabilitation effort—at its will. Such a result is entirely at odds with the original purpose of § 366.

In this Article we discuss how bankruptcy courts are likely to maintain the balance § 366 was intended to create. We believe the courts, as they did pre-BAPCPA, will continue to approach debtor-utility issues with the intent of balancing the debtor's interest in successful rehabilitation and the utility's interest in minimizing risk. Courts can do so while remaining consistent with Congress' apparent intent to give utilities better protection by reading a good faith requirement into the utility satisfaction language.[7] Not only is this approach consistent with pre-BAPCPA § 366 analyses, it is also consistent with other federal and state law provisions.[8]

In Part I of this Article, we discuss the origins of § 366, including the purpose behind the original enactment of § 366 and the procedure that developed pre-BAPCPA. The case law demonstrates courts were willing to exercise broad discretion to achieve the appropriate balance of interests dictated by the circumstances of the particular case.[9] In Part II, we discuss the sweeping changes made to § 366 by BAPCPA, which seem to have the effect of shifting the previous balance in favor of utilities. In Part III, we begin to look at the application of § 366 post-BAPCPA. The first step, as discussed in this Part, is determining when § 366, and subsection (c) in particular, applies. We also illustrate how courts may use the applicability rules as yet another method of avoiding the harsh result of § 366's plain language. In Part IV, we examine the wisdom of imposing a good faith requirement on utilities as well as discuss possible tests bankruptcy courts may use in determining whether a utility has acted in good faith. We conclude bankruptcy courts will likely read an implied good faith requirement into § 366(c) to better achieve the balance between chapter 11 debtor and utility interests that § 366 was intended to create.

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[6] 11 U.S.C.S. § 366(c)(2).
[7] *See infra* Part IV.
[8] *See id.*
[9] *See infra* notes 40–49.

## I. THE ORIGINS OF § 366

Utility services such as electricity and telephone services are essential to the continued operation of the chapter 11 business debtor. Without such services, the debtor may be unable to manufacture its product or communicate with customers and would have no possibility of successful reorganization.[10] As a result, courts have come to view utility services as a necessary minimum for rehabilitation.[11]

Problems arise in bankruptcy, however, because utilities generally enjoy monopoly power in a given region and the debtor is unable to obtain, or at least easily obtain, a new source of supply.[12] The utility may attempt to use its position to coerce the debtor into paying prepetition debts or granting other security with threats of terminating future service.[13] If it acquiesces, the debtor may be forced into an even more precarious financial position.[14] Moreover, granting preferential treatment to the utility prejudices the debtor's remaining creditors by disrupting the bankruptcy distribution scheme.[15] On the other hand, the utility has a legitimate business concern if forced to provide service to the debtor while prevented from obtaining overdue payments or future security from the debtor.[16]

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[10] *See* S. Cent. Bell Tel. Co. v. Simon (*In re* Fontainebleau Hotel Corp.), 508 F.2d 1056, 1058 (5th Cir. 1975) (termination of service under existing telephone number would substantially impair debtor's business); *In re* Kassuba, 396 F. Supp. 324, 326 (N.D. Ill. 1975) (termination of telephone service detrimental to debtor's rehabilitation); Marion Steel Co. v. Ohio Edison Co. (*In re* Marion Steel Co.), 35 B.R. 188, 191, 199 (Bankr. N.D. Ohio 1983) (termination of electricity presented threat to safety of property and employees).

[11] *See* Whittaker v. Phila. Elec. Co. (*In re* Whittaker), 882 F.2d 791, 794 (3d Cir. 1989); *In re* Moorefield, 218 B.R. 795, 796 (Bankr. M.D.N.C. 1997).

[12] *See In re* Woodland Corp., 48 B.R. 623, 624 (Bankr. D.N.M. 1985). These characteristics have been built into the definition of what constitutes a "utility." *See infra* Part III.A.

[13] *See* Ga. Power Co. v. Sec. Inv. Props. Inc. (*In re* Sec. Inv. Props., Inc.), 559 F.2d 1321, 1325 (5th Cir. 1977); *Woodland*, 48 B.R. at 624; *Marion Steel*, 35 B.R. at 200; Veryl Victoria Miles, *Adequate Assurance of Payment Under Section 366 of the Bankruptcy Code: A Term for Interpretive Flexibility or Judicial Confusion?*, 20 AKRON L. REV. 715, 716 (1987) (citing H.R. DOC. NO. 93–137, at 24 (1973)). Generally, creditors are prevented from collecting prepetition debts by the automatic stay, which comes into effect automatically upon the filing of a bankruptcy petition. *See* 11 U.S.C. § 362 (2000).

[14] *See Kassuba*, 396 F. Supp. at 326; *Marion Steel*, 35 B.R. at 198–99.

[15] *See Woodland*, 48 B.R. at 624; *Marion Steel*, 35 B.R. at 200; *see also* 11 U.S.C. § 1123 (distribution schemes under chapter 11).

[16] *See Sec. Inv. Props.*, 559 F.2d at 1325 (expressing concern regarding resulting prejudice to creditor under the Bankruptcy Act if debtor could exercise right to receive future service while being "immune from any condition of payment or security").

Although utility services were not singled out in the original Bankruptcy Act of 1898,[17] courts applying the Bankruptcy Act took note of the special relationship that existed between debtors and utility companies and the special concerns that resulted.[18] Consequently, when the Bankruptcy Code was enacted in 1978,[19] Congress specifically intended § 366 to address the particular issues arising out of the debtor-utility relationship.[20] The first version of § 366, which took effect on October 1, 1979,[21] read as follows:

> (a) Except as provided in subsection (b) of this section, a utility may not alter, refuse, or discontinue service to, or discriminate against, the trustee or the debtor solely on the basis that a debt owed by the debtor to such utility for service rendered before the order for relief was not paid when due.
> (b) Such utility may alter, refuse, or discontinue service if neither the trustee nor the debtor, within 20 days after date of the order for relief, furnishes adequate assurance of payment, in the form of a deposit or other security, for service after such date. On request of a party in interest and after notice and a hearing, the court may order reasonable modification of the amount of the deposit or other security necessary to provide adequate assurance of payment.[22]

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17 Bankruptcy Act of 1898, ch. 541, 30 Stat. 544 (repealed 1979) [hereinafter, the "Bankruptcy Act"]; *see In re* Monroe Well Serv., Inc., 83 B.R. 317, 321 (Bankr. E.D. Pa. 1988). We would submit utility services were not sufficiently widespread at the time the Bankruptcy Act was enacted to present a particular concern to "bankrupts," as debtors were known under the Bankruptcy Act. *See* Bankruptcy Act, *supra*, § 1(4).

18 The pre-Bankruptcy Code courts grappled with such issues as whether a bankruptcy court had summary jurisdiction to enter an injunction, *see, e.g.*, Solomon v. Pac. Tel. & Tel. Co (*In re* U.S. Fin., Inc.), 594 F.2d 1275, 1280–81 (9th Cir. 1979); S. Cent. Bell Tel. Co. v. Simon (*In re* Fontainebleau Hotel Corp.), 508 F.2d 1056, 1058–59 (5th Cir. 1975); Rothman v. Pac. Tel. & Tel. Co. (*In re* Best Re-Mfg. Co.), 453 F.2d 848, 849–50 (9th Cir. 1971); Slenderella Sys. of Berkeley, Inc. v. Pac. Tel. & Tel. Co., 286 F.2d 488, 490 (2d Cir. 1961); whether a utility could demand payment of a prepetition debt as a condition of providing postpetition services, *see, e.g.*, *In re U.S. Fin., Inc.*, 594 F.2d at 1279–80; *Fontainebleau*, 508 F.2d at 1060; *Kassuba*, 396 F. Supp. at 326; *In re* Penn Cent. Transp. Co., 328 F. Supp. 1276, 1278 (E.D. Pa. 1971); *In re* Burbank Corp., 48 F. Supp. 172, 174 (S.D. Cal. 1943); and whether a utility is entitled to what amounted to adequate assurance of payment, *see*, *e.g.*, *Sec. Inv. Props., Inc.*, 559 F.2d at 1326; *Burbank*, 48 F. Supp. at 174.

19 The Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2549 (1978), which repealed the Bankruptcy Act, is codified in title 11 of the U.S. Code. *See* Bankruptcy Reform Act of 1978 § 401, 92 Stat. at 2682.

20 *See* Begley v. Phila. Elec. Co. (*In re* Begley), 760 F.2d 46, 48 (3d Cir. 1985) (§ 366 enacted to clarify court's power regarding utility services); *Monroe Well Svc.*, 83 B.R. at 321 (§ 366 "represents a conscious desire to overrule pre-Bankruptcy Code decisions to the contrary"); *In re* Penn Jersey Corp., 72 B.R. 981, 984 (Bankr. E.D. Pa. 1987) (§ 366 enacted to resolve split in courts regarding treatment of utility service providers under Bankruptcy Act).

21 *See* Bankruptcy Reform Act of 1978 § 402(a), 92 Stat. at 2682.

22 11 U.S.C. § 366 (1978).

Subsection (a) was subsequently amended to include commencement of a bankruptcy case as an additional basis upon which utility service could not be altered, refused, or discontinued.[23]

The legislative history indicates Congress intended § 366 to give "debtors protection from a cut-off of service" by the prohibition set forth in subsection (a).[24] At the same time, the concept of adequate assurance of payment set forth in subsection (b) was intended to protect utility companies.[25] The dual purpose of § 366 reflects the dual purpose of the Bankruptcy Code itself. The first goal of bankruptcy is to provide a debtor with relief from creditors so he or she is able to rehabilitate and accumulate new wealth in the future.[26] The second goal is to provide an orderly distribution of the debtor's assets to its creditors.[27] Section 366 furthers these goals by providing the debtor an automatic twenty-day breathing period under subsection (a) and by permitting the utility to obtain adequate assurance of payment or terminate service after the twenty-day period has lapsed under subsection (b).[28] When interpreting and applying § 366 in the past, courts have focused on this dual purpose and emphasized the *balance* between interests that § 366 and the Code in general seek to achieve.[29]

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[23] Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. No. 98-353 § 443, 98 Stat. 333.

[24] S. REP. NO. 95-989, at 60 (1978), *as reprinted in* 1978 U.S.C.C.A.N. 5787, 5846 ("This section gives debtors protection from a cut-off of service by a utility because of the filing of a bankruptcy case."). The House Report added subsection (b) was intended to "prevent a utility from terminating service until there is a court hearing, if there is a dispute over what is adequate assurance." *See* H.R. REP. NO. 95-595, 351 (1977), *as reprinted in* 1978 U.S.C.C.A.N. 5963, 6306.

[25] *See* H.R. REP. NO. 95-595, at 351, 1978 U.S.C.C.A.N., at 6306 ("Subsection (b) protects the utility company by requiring the trustee or the debtor to provide, within ten days, adequate assurance of payment for service provided after the date of the petition.") Note the twenty-day period provided for in subsection (b) was a compromise between the original Senate version, which called for a ten day period, and the House version, which called for a thirty day period. *See* S. REP. NO. 95-989, at 60, 1978 U.S.C.C.A.N., at 5846; HR. REP. NO. 95-595, at 351, 1978 U.S.C.C.A.N., at 6306.

[26] *See* Burgess v. Sikes (*In re* Burgess), 438 F.3d 493, 497 (5th Cir. 2006).

[27] *See id.*

[28] *See* Simon Kimmelman, *"Let There Be Light"?: The Pitfalls and Possibilities for Utilities Under the Bankruptcy Code*, 57 AM. BANKR. L.J. 155, 157 (1983); Miles, *supra* note 13, at 720 (citing BLACK ON BANKRUPTCY § 10 (4th ed. 1926)).

[29] *See, e.g.*, One Stop Realtour Place, Inc. v. Allegiance Telecom, Inc. (*In re* One Stop Realtour Place, Inc.), 268 B.R. 430, 437 (Bankr. E.D. Pa. 2001) ("Even in the face of asserted market changes, Section 366 must still balance the debtor's need for continued access to necessary services, such as electricity, gas or telephone service, against the rights of the utility companies to adequate assurance of payment."); Marion Steel Co. v. Ohio Edison Co. (*In re* Marion Steel Co.), 35 B.R. 188, 198 (Bankr. N.D. Ohio 1983); *In re* Santa Clara Circuits W., Inc., 27 B.R. 680, 685 (Bankr. D. Utah 1982); Va. Elec. & Power Co. v. Cunha (*In re* Cunha), 1 B.R. 330, 333 (Bankr. E.D. Va. 1979).

To begin, § 366 is intended to be "self-executing."[30] Subsection (a) automatically comes into effect upon entry of the order for relief, preventing the utility from altering, refusing, or discontinuing service without, for example, a motion by the debtor for an injunction.[31] In theory, within the next twenty days, the debtor and utility will negotiate the type or amount of adequate assurance payment the debtor is to provide. The utility may make a demand or may leave the burden on the debtor to come forward with a proposal.[32] If no adequate assurance is provided within twenty days, the utility is expressly allowed to terminate service.[33] For this reason, it may be in the best interest of the debtor to initiate communication to avoid service disruption.[34] This can all be done without judicial determination.[35]

Nevertheless, a party in interest, which includes the debtor, trustee, utility, or other creditor,[36] may initiate a proceeding for a hearing and determination by the court; in practice, it is usually the subject of a first day motion.[37] Section 366 issues that have been the subjects of litigation include: (1) the definition of the term "utility," (2) whether a utility may terminate service for some reason other than prepetition indebtedness or filing of a bankruptcy petition, (3) whether prepetition indebtedness is a prerequisite for adequate assurance of payment, and (4) what constitutes adequate assurance of payment.[38]

Determination of what constitutes adequate assurance of payment appears to be the most heavily litigated issue. In part, this is because under § 366 as enacted in 1978, "adequate assurance of payment" was not defined.[39] In approaching this issue, courts have emphasized four important concepts.

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[30] *See In re* Penn Jersey Corp., 72 B.R. 981, 984 (Bankr. E.D. Pa. 1987) (characterizing this aspect of § 366 as a "God-send" for bankruptcy courts).

[31] An order for relief is entered upon commencement of a bankruptcy case, which occurs when the debtor files the bankruptcy petition. 11 U.S.C. § 301 (2000).

[32] *See In re* Robmac, Inc., 8 B.R. 1, 3 (Bankr. N.D. Ga. 1979). It has been held a utility does not violate the automatic stay of 11 U.S.C. § 362 by demanding adequate assurance of payment. *See Santa Clara Circuits W.*, 27 B.R. at 683.

[33] *See Robmac*, 8 B.R. at 3.

[34] *See* Miles, *supra* note 13, at 728.

[35] *See Santa Clara Circuits W.*, 27 B.R. at 683.

[36] *See In re* Penn Jersey Corp., 72 B.R. 981, 985 (Bankr. E.D. Pa. 1987) (party in interest includes debtor's creditors); *Robmac*, 8 B.R. at 3 (party in interest includes utility, debtor, and trustee).

[37] *See* Stuart A. Laven, Jr., *First-day Motions Under the New Code Careful Planning Required*, 24 AM. BANKR. INST. J. 12, 12 (2005).

[38] Miles, *supra* note 13, at 717; *see infra* Part III.A for further discussion regarding the definition of "utility."

[39] *See* 11 U.S.C. § 366 (1978); Miles, *supra* note 13, at 717–19.

First, bankruptcy courts have broad power when applying § 366.[40] The equitable power created by § 366 is supplemented by the power under § 105 to "issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of [title 11]."[41] This permits the court to fashion an appropriate remedy in its sound discretion.[42] Second, bankruptcy courts act with significant flexibility and discretion under § 366.[43] In this context, courts "must not be shackled with unnecessarily rigid rules"[44] but rather demonstrate "flexibility and sensitivity."[45] Third, a determination under § 366 is fact-intensive and depends on the totality of circumstances presented by the individual case.[46] What constitutes adequate assurance of payment in one case, for example, may be insufficient or more than adequate in another case.[47] Finally, the § 366 determination is heavily informed by the original purpose of § 366. That is, courts consistently "balance the debtor's need for continued access to necessary services, such as electricity, gas, or telephone service, against the rights of the utility companies to adequate assurance of payment."[48] Further, "[i]n a Chapter 11 case, entitlement to adequate assurance should be reconciled with the rehabilitative function of Chapter 11 . . . ."[49] Thus, courts will be reluctant to approve a financial burden that thwarts this rehabilitative function.[50]

Factual considerations informing the adequate assurance of payment determination have included: the debtor's payment history,[51] the debtor's net worth,[52] the debtor's present and future ability to pay postpetition

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40 *See, e.g.*, Marion Steel Co. v. Ohio Edison Co. (*In re* Marion Steel Co.), 35 B.R. 188, 195 (Bankr. N.D. Ohio 1983.)

41 11 U.S.C. § 105 (2000); *see Marion Steel*, 35 B.R. at 195.

42 *See Marion Steel*, 35 B.R. at 195. For example, it is this power that courts have cited when extending the twenty-day period of § 366. *See, e.g.*, *In re* George C. Frye Co., 7 B.R. 856, 857 n.2 (Bankr. D. Me. 1980); Kimmelman, *supra* note 28, at 163.

43 *See* Va. Elec. & Power Co. v. Caldor, Inc.-NY, 117 F.3d 646, 650–51 (2d Cir. 1997).

44 *Id.* at 650 (refusing to create a strict definition of "security" of "adequate assurance").

45 *In re* Utica Floor Maint., Inc., 25 B.R. 1010, 1013–14 (N.D.N.Y. 1982) (citing instances of flexibility in previous cases).

46 *See infra* note 47.

47 *See Caldor*, 117 F.3d at 650–51; *see also In re* Robmac, Inc., 8 B.R. 1, 4 (Bankr. N.D. Ga. 1979) ("Naturally, the payment plan determined to protect the competing interests of the debtor and utility will vary with the specific circumstances of the particular case.").

48 One Stop Realtour Place, Inc. v. Allegiance Telecom, Inc. (*In re* One Stop Realtour Place, Inc.), 268 B.R. 430, 437 (Bankr. E.D. Pa. 2001).

49 *In re* 499 W. Warren St. Assocs., 138 B.R. 363, 365 (Bankr. N.D.N.Y. 1991).

50 *See id.*

51 *See In re* Best Prods. Co., 203 B.R. 51, 54 (Bankr. E.D. Va. 1996).

52 *See id.*

obligations,[53] the debtor's liquidity or borrowing capability,[54] the length of time necessary for the utility to effect termination once the billing cycle is missed,[55] the prepetition security required,[56] the debtor's cash requirements,[57] the probability of payment through distribution under the bankruptcy laws,[58] the degree by which the risks of nonpayment from the debtor exceed the risks of nonpayment from the utility's other customers,[59] whether the utility owes a debt to the debtor,[60] whether the debtor and utility are industry competitors,[61] prejudice to other creditors,[62] regulations imposed by state law,[63] and whether the proposed payments further the rehabilitative function and strike the appropriate balance dictated by the purpose of § 366.[64]

With these concepts and factual considerations in mind, bankruptcy courts have concluded the amount and type of adequate assurance of payment vary from case to case. The amount or type, however, may not be more than is sufficient to protect the utility from unreasonable risk of nonpayment.[65] The focus is on "the *need* of the utility for assurance."[66] Anything more is an unreasonable demand that deters rehabilitation potential.[67] An absolute guarantee of payment is not required.[68] Moreover, a deposit is not necessarily required.[69] In fact, courts have held, in some circumstances, the utility is protected by the status quo, and nothing additional is required of the debtor.[70]

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53 *See id.*

54 *See In re* Adelphia Bus. Solutions, 280 B.R. 63, 83 (Bankr. S.D.N.Y. 2002).

55 *See* Begley v. Phila. Elec. Co. (*In re* Begley), 760 F.2d 46, 49 (3d Cir. 1985).

56 *See In re* Santa Clara Circuits W., Inc., 27 B.R. 680, 685 (Bankr. D. Utah 1982).

57 *See id.*

58 *See id.*

59 *See id.*

60 *See In re* Adelphia Bus. Solutions, 280 B.R. 63, 83 (Bankr. S.D.N.Y. 2002).

61 *See id.* at 83 n.121.

62 *See id.* at 86.

63 *See* Steinebach v. Tucson Elec. Power Co. (*In re* Steinebach), 303 B.R. 634, 642 (Bankr. D. Ariz. 2004).

64 *See* Marion Steel Co. v. Ohio Edison Co. (*In re* Marion Steel Co.), 35 B.R. 188, 198 (Bankr. N.D. Ohio 1983).

65 *See id.*

66 *In re* Penn Jersey Corp., 72 B.R. 981, 985 (Bankr. E.D. Pa. 1987).

67 *See id.*

68 *See* Mass. Elec. Co. v. Keydata Corp. (*In re* Keydata Corp.), 12 B.R. 156, 158 (B.A.P. D. Mass. 1981).

69 *See, e.g.*, *Penn Jersey*, 72 B.R. at 985.

70 *See id.* at 986 ("We believe that situations exist where the debtor should not be obliged to do anything–except, of course, to maintain post-petition payments–to continue to have a right to receive post-petition utility service."); *see also* Puget Sound Energy, Inc. v. Pac. Gas & Elec. Co. (*In re* Pac. Gas & Elec. Co.), 271 B.R. 626, 645 (N.D. Cal. 2002).

On the other hand, a court may require a deposit equal to several months of service.[71]

The ultimate determination rests on whether the balance sought to be achieved by § 366 is achieved given the facts of the individual case and, in chapter 11 cases, whether the rehabilitative function is furthered. Bankruptcy courts have broad power and discretion to ensure these goals are achieved, and they have consistently exercised this power and discretion in the context of § 366. As discussed further in the remainder of this Article, although BAPCPA appears to threaten the rehabilitative function of § 366, we believe bankruptcy courts will continue to exercise their power and discretion to ensure the concept of balance embodied in § 366 is satisfied.

## II. SECTION 366 IN THE AFTERMATH OF BAPCPA

After nearly a decade of congressional debate, BAPCPA was passed and signed by President George W. Bush on April 20, 2005.[72] The majority of its provisions became effective on October 17, 2005.[73] Although BAPCPA has become notorious for the changes it made to consumer bankruptcies, significant changes were also made affecting chapter 11 debtors.[74] Those changes include significant modification to § 366. Specifically, section 417 of BAPCPA added a subsection (c) to § 366, which provides:

> (c)(1)(A) For purposes of this subsection, the term "assurance of payment" means –
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> (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.
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> (B) For purposes of this subsection an administrative expense priority shall not constitute an assurance of payment.

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[71] *See, e.g.*, *In re* Santa Clara Circuits W., Inc., 27 B.R. 680, 687 (Bankr. D. Utah 1982).

[72] Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, 119 Stat. 23 (2005).

[73] *Id.* § 1501.

[74] *See* Richard Levin & Alesia Ranney-Marinelli, *The Creeping Repeal of Chapter 11: The Significant Business Provisions of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005*, 79 AM. BANKR. L.J. 603, 603 (2005).

> (2) Subject to paragraphs (3) and (4), with respect to a case filed under chapter 11, a utility referred to in subsection (a) may alter, refuse or discontinue utility service, if during the 30-day period beginning on the date of the filing of the petition, the utility does not receive from the debtor or the trustee adequate assurance of payment for utility service that is satisfactory to the utility.
> (3)(A) On request of a party in interest and after notice and a hearing, the court may order modification of the amount of an assurance of payment under paragraph (2).
> (B) In making a determination under this paragraph whether an assurance of payment is adequate, the court may not consider–
> (i) the absence of security before the date of the filing of the petition;
> (ii) the payment by the debtor of charges for utility service in a timely manner before the date of the filing of the petition; or
> (iii) the availability of an administrative expense priority.
> (4) Notwithstanding any other provision of law, with respect to a case subject to this subsection, a utility may recover or set off against a security deposit provided to the utility by the debtor before the date of the filing of the petition without notice or order of the court.[75]

The new subsection (c) only applies in chapter 11 cases.[76] The most obvious change is the inclusion of a definition of "assurance of payment."[77] The definition purports to limit the types of security that are acceptable as assurance of payment. This limitation appears to weigh in favor of utilities, effectively guaranteeing utilities "an outlay of cash or its equivalent."[78] Moreover, by adding subsection (c)(3)(B), "Congress removed the typical arguments that debtors used in asserting that the utility provider did not need a

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[75] Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, § 417, 11 U.S.C. § 366(c). The legislative history sheds no light on the Congressional intent underlying the amendments. *See* H.R. REP. NO. 109-31, at 89 (2005), *as reprinted in* 2005 U.S.C.C.A.N. 88, 155 (merely summarizing the amendments to § 366). At least one commentator has suggested the amendment reflects the "influence of utilities." *See* Peter S. Fishman, *Not So Fast: Asset Sales Under the New § 363*, 24 AM. BANKR. INST. J. 12, 81 (2005). On the other hand, at least the addition of the definition of "assurance of payment" was recommended by another commentator in order to reduce litigation and resolve the split in authority among courts. *See* Miles, *supra* note 13.

[76] *See In re* Astle, 338 B.R. 855, 859 (Bankr. D. Idaho 2006). When subsection (c) applies and whether it applies to the exclusion of subsection (b) is discussed further in Part III, *infra*.

[77] Note § 366(c)(1) defines "assurance of payment" but not "*adequate* assurance of payment." *See* Bruce H. White & William L. Medford, *Utilities and the New (and Improved?) § 366*, 24 AM. BANKR. INST. J. 36, 35 (2005).

[78] *Id.* at 37; *see* Fishman, *supra* note 75, at 81 ("[E]ssentially all 'cashless' forms of adequate assurance of post-petition utility payments have been eliminated.").

cash deposit or its equivalent."[79] These changes will significantly affect the liquidity of an already financially troubled chapter 11 debtor.[80]

This Article focuses on the less obvious but perhaps more ominous change in § 366(c)(2), which requires adequate assurance of payment "satisfactory to the utility."[81] Such language appears to create "a significant shift in the balance of power toward utilities,"[82] disrupting the balance between debtor interests and utility interests § 366 was originally intended to preserve. It does so preliminarily, some have suggested, by giving utilities the "upper hand" in initial negotiations between the debtor and utility for the appropriate assurance of payment.[83] Although subsection (c)(3) gives the debtor the right to have the court modify the adequate assurance of payment,

> that right arises only after the adequate assurance of payment has been agreed upon by the parties. In other words, the trustee or debtor in possession has no recourse to modify the adequate assurance payment the utility is demanding until the trustee or debtor in possession actually accepts what the utility proposes.[84]

This, at least, is the interpretation set forth in *In re Lucre*, *Inc.*,[85] the first post-BAPCPA opinion issued dealing with § 366. The debtor in *Lucre* asked the court to extend the subsection (a) injunction against two of its utility providers, something that was regularly done pre-BAPCPA,[86] because the utilities did not respond to the debtor's offers of assurance of payment.[87] The court refused, asserting subsection (c) did not give it the discretion to do so when the utility had not accepted the debtor's offer and the debtor had not accepted the offer of the utility.[88]

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79 White & Medford, *supra* note 77, at 37.

80 *See* Fishman, *supra* note 75, at 81. Two commentators suggest a debtor maintain "a standby letter of credit or other collateral, equal to one or two months or utility service for all utilities, naming each utility as a beneficiary, with a draw conditioned on certain notice provisions." Michelle M. Harner & Carl E. Black, *A Chapter 11 Debtor's Life After Oct. 17: Not so Bad if You Effectively Plan*, 24 AM. BANKR. INST. J. 36, 37 (2005).

81 11 U.S.C.S. § 366(c)(2) (2006).

82 WILLIAM HOUSTON BROWN & LAWRENCE R. AHERN III, 2005 BANKRUPTCY REFORM LEGISLATION WITH ANALYSIS 93 (2005).

83 White & Medford, *supra* note 77, at 37.

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

85 *Id.*

86 *See supra* note 42.

87 *Lucre*, 333 B.R. at 154.

88 *Id.*

The court denied the request without prejudice to whatever right the debtor may later have to enjoin the utilities under section (c).[89] It acknowledged such an effort "would appear to be a fool's errand" upon a superficial reading of the new § 366.[90] However, the court suggested a good faith requirement might "exist with respect to a utility's exercise of its rights under subsection (c)."[91] That is, subsection (c) could be read "to require a utility to bargain in good faith with the trustee or debtor in possession ["DIP"] before electing to discontinue service thereunder [sic]."[92]

Commentators are correct that BAPCPA shifts the balance of power under § 366 in favor of utilities on its face.[93] Pre-BAPCPA, however, bankruptcy courts exercised broad power and discretion to maintain the balance between debtors and utilities that § 366 was originally intended to create.[94] The *Lucre* decision is an indication courts are likely to continue to exercise their § 366 authority supplemented by their equitable powers granted in § 105.[95] By reading a good faith requirement into the subsection (c) language that requires adequate assurance of payment be "satisfactory to the utility," courts can take into account the factual circumstances of the particular case and purpose of § 366 while remaining consistent with the provisions of the Bankruptcy Code.[96] As a result, the balance between debtor interests and utility interests will be maintained.

## III. THE APPLICABILITY OF SUBSECTION (c)

Section 366 applies to the action of a "utility." Courts have attempted to define "utility" since § 366 was originally enacted. BAPCPA creates a new possible distinction between "service" and "utility service."[97] Further, although subsection (c) applies only in chapter 11 cases, it is unclear whether

89 *Id.*
90 *Id.*
91 *Id.*
92 *Id.*
93 *See* BROWN & AHERN, *supra* note 82, at 93; Justin Scheck, *Bankruptcy Avalanche?*, THE RECORDER, Feb. 7, 2006, at 1 (quoting a report in which UCLA School of Law professor Kenneth Klee states "utilities will have 'a tremendous amount of power'" under the new law).
94 *See supra* notes 24–29 and accompanying text.
95 *Cf. supra* notes 40–42.
96 *Cf.* MFS Telecom, Inc. v. Motorola, Inc. (*In re* Conxus), 262 B.R. 893, 899 (D. Del. 2001) ("While Section 105(a) gives a bankruptcy court general equitable powers, those powers are limited by the provisions of the Bankruptcy Code.").
97 *See infra* Part III.B.

subsection (c) applies to the exclusion of subsection (b) in chapter 11 cases. This Part addresses when the new subsection (c) applies, and thus, when good faith becomes a requirement. Moreover, these rules of applicability present the court with viable options for avoiding the harsh effects of subsection (c) entirely.

### A. *The Definition of "Utility"*

By its terms, § 366 applies to a "utility." The term "utility," however, is not defined in the Bankruptcy Code. Consequently, courts have been attempting to define "utility" since 1979. They have been aided by the legislative history of the Bankruptcy Reform Act of 1978.[98] The House and Senate Reports both provide:

> This section is intended to cover utilities that have some special position with respect to the debtor, such as an electric company, gas supplier, or telephone company that is a monopoly in the area so that the debtor cannot easily obtain comparable service from another utility.[99]

The legislative history makes clear utilities are treated differently from other creditors because "such services are often available only from a single source."[100] As a result, many courts focus on the monopolistic nature of the industry for purposes of applying § 366.[101] This approach creates problems in an environment of deregulation. In *In re One Stop Realtour Place, Inc.*, for example, the alleged utility argued it was not a monopoly, and thus not a "utility" because other companies provided the same or equivalent services to commercial customers in the region.[102]

Early versions of BAPCPA indicated Congress recognized the problem that deregulation created for the court-developed definition of "utility."[103] The early versions added a definition to § 366 that was to read: "For the purposes of this section, the term 'utility' includes any provider of gas, electric, telephone, telecommunication, cable television, satellite communication,

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[98] *See* Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2549 (1978).

[99] S. REP. NO. 95-989, at 60 (1978), *as reprinted in* 1978 U.S.C.C.A.N. 5787, 5847; H. REP. NO. 95-595, at 349 (1977), *as reprinted in* 1978 U.S.C.C.A.N. 5963, 6306.

[100] Whittaker v. Phila. Elec. Co. (*In re* Whittaker), 882 F.2d 791, 794 (3d Cir. 1989).

[101] *See, e.g.*, *In re* Gehrke, 57 B.R. 97, 97–98 (Bankr. D. Or. 1985).

[102] One Stop Realtour Place, Inc. v. Allegiance Telecom, Inc. (*In re* One Stop Realtour Place, Inc.), 268 B.R. 430, 435–36 (Bankr. E.D. Pa. 2001).

[103] Consumer Bankruptcy Reform Act of 1998, H.R. 3150, 105th Cong. § 119.

water, or sewer service, whether or not such service is a regulated monopoly."[104] Obviously, this definition did not make it into the final version of BAPCPA.[105]

Nevertheless, it does not appear deregulation should upset the application of § 366 for two reasons. First, at least one court has taken a "plain meaning" approach to defining "utility."[106] In *One Stop Realtour Place*, the court concluded the word "utility" was not ambiguous and thus, under the rules of statutory construction, the court did not look to the legislative history from which the monopoly-centered definition originated.[107] Instead, the court used the ordinary dictionary definition of "utility," which includes services "(such as light, power, or water) provided by a public utility. The term 'public utility' is defined as 'a business organization (as an electric company) performing a public service and subject to special governmental regulation.'"[108] Because the service provider in *One Stop Realtour Place* provided telephone service to the public and was subject to government regulation, the court concluded it was a utility notwithstanding the availability of other providers.[109] While this approach certainly encompasses traditional utility services, it may tend to exclude more modern or non-traditional utility-type services, such as cable television or internet service providers. Such services might be a necessary minimum requirement for those debtors who conduct business entirely over the internet.

A second approach may bring these services within the scope of § 366. "Notwithstanding the legislative history, the term 'utility' was, from the beginning, given a broad meaning."[110] In *In re Good Time Charlie's Ltd.*, the court concluded the service provider need not be a monopoly.[111] The service provider would be considered to occupy a "special position with respect to the debtor," and thus constitute a utility, if the debtor would be forced to incur a

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[104] *Id.*

[105] *See* 11 U.S.C.S. § 366 (2006). Although the legislative history indicates the original inclusion of a definition of "utility" was to protect utilities in the "wake of deregulation," there is no explanation of why the definition was excluded from the final legislation. *Compare* H.R. REP. NO. 109-31, at 89 (2005) *with* H.R. REP. NO. 105-540, at 15 (1998).

[106] *See One Stop Realtour Place*, 268 B.R. 430.

[107] *Id.*

[108] *Id.* at 435.

[109] *Id.* at 436.

[110] *Id.*

[111] Good Time Charlie's Ltd. v. Black (*In re* Good Time Charlie's Ltd.), 25 B.R. 226, 227 (Bankr. E.D. Pa. 1982).

large or prohibitive expense if required to obtain services elsewhere.[112] In other words, this approach focuses not on the monopolistic nature of the utility, but on the legislative history requirement that the debtor "cannot easily obtain comparable service."[113] Using this broad definition, courts have deemed shopping malls[114] and condominium homeowners associations to be utilities.[115] Because courts are armed with the monopoly approach, plain meaning approach, and prohibitive expense approach, the limitation of § 366 to a "utility" provides little if any hurdle to its applicability.

### *B. "Service" v. "Utility Service": The Non-End-User Dilemma*

A second hurdle to the applicability of § 366(c) may have been a possible issue pre-BAPCPA, but BAPCPA ensures it will now a heavily litigated issue. Subsections (a) and (b) have always referred to "service" and continue to do so post-BAPCPA.[116] For example, a utility may not discontinue *service*. The new subsection (c), however, refers only to "utility service."[117] A utility may not discontinue *utility* service. If courts give meaning to every word of Congress, as they should under the rules of statutory interpretation,[118] the difference may have a significant effect.

The difference was pointed out by the *Lucre* court. There, the court commented:

> It is common now for utilities to offer services beyond simply those used by consumers. Indeed, this transformation is at least in part the result of legislation enacted by Congress to make utilities more competitive. Consequently, it is fair to assume that the Congress recognized the difference in services provided by utilities when it recently amended Section 366 and that Congress therefore purposely excluded services provided between utilities . . . from the more stringent requirements of subsection (c). In other words, "utility service" in subsection (c) means only traditional services that the debtor in possession itself consumes in contrast to other services and

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[112] *Id.*
[113] *Id.*
[114] *Id.*
[115] Hobbs v. Summit House Condos. (*In re* Hobbs), 20 B.R. 488, 489–90 (Bankr. E.D. Pa. 1982).
[116] *Compare* 11 U.S.C. § 366(a)–(b) (2000) *with* 11 U.S.C.S. § 366(a)–(b) (2006).
[117] 11 U.S.C.S. § 366(c) (2006).
[118] *See* Bend v. Hoyt, 38 U.S. (13 Pet.) 263, 272 (1839).

> rights provided by the utility, such as interconnection agreement services.[119]

Under this approach, for services to constitute "utility services" and for subsection (c) to apply, the debtor must be the "end-user" of the services provided.[120] As a result, in *Lucre*, where the chapter 11 debtor purchased telecommunication services from two companies and passed those services on to its own customers, the court held subsection (c) did not apply and instead permitted the debtor to furnish adequate assurance of payment under subsection (b).[121]

If, however, Congress did not intend to create a distinction between services and utility services, the *Lucre* court questioned whether § 366 would apply at all when the debtor is not an end-user.[122] This argument returns to the definition of "utility." When services are passed on to the debtor's customers, the situation would appear to be no different from a retailer reselling goods it purchased from a wholesaler—a situation in which no special provision such as § 366 applies. This sort of service can certainly be readily distinguished from the electricity or telephone services considered a necessary minimum for the chapter 11 debtor's rehabilitation.

If the distinction is drawn at this level such that providers of services for which the debtor is not an end-user are deemed by courts to not fit within the definition of "utility," § 366 would not apply at all and, therefore, would not protect either the debtor or creditor. The service provider would be treated like other non-utility creditors. The § 362 automatic stay would apply to its actions, and the service provider may be left with only an administrative expense priority under § 503, which is presumably what § 366(c)(1) was meant to eliminate.[123] In summary, the harsh effects of the new subsection (c) can be avoided by drawing a distinction between service and utility service such that subsection (b) applies or § 366 does not apply at all. Courts may choose either

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119 *In re* Lucre, Inc., 333 B.R. 151, 155 (Bankr. W.D. Mich. 2005).

120 For cases in which the debtor was not an end-user and in which the service-utility service distinction would have applied had subsection (c) been in effect, see *Puget Sound Energy, Inc. v. Pac. Gas & Elec. Co.* (*In re Pac. Gas & Elec. Co.*), 271 B.R. 626 (N.D. Cal. 2002); *MFS Telecom v. Motorola, Inc. (In re Conxus Commc'ns, Inc.)*, 262 B.R. 893 (D. Del. 2001); *In re Tel-Cent. Commc'ns, Inc.*, 212 B.R. 342 (Bankr. W.D. Mo. 1997).

121 *Lucre*, 333 B.R. at 155.

122 *Id.* at 155 n.5. At least one commentator has raised this issue pre-BAPCPA. *See* WARREN E. AGIN, BANKRUPTCY AND SECURED LENDING IN CYBERSPACE 5–49 (3d ed. 2005).

123 *See* 11 U.S.C.S. §§ 362, 366, 503 (2006).

of these two approaches as yet another method of dealing with the shift in the balance of power BAPCPA has created.

*C. The Interplay Between Subsections (b) and (c)*

The final issue in determining whether subsection (c) applies is whether subsection (c) applies to the exclusion of subsection (b). By its terms, subsection (c) applies in chapter 11 cases.[124] The question is whether subsection (b) also applies in chapter 11 cases. The legislative history sheds no light on this question.[125]

*Collier on Bankruptcy*, the preeminent bankruptcy treatise, contends subsection (c) applies to the exclusion of subsection (b) because it appears to deal "with the same issues and procedures that are more generally dealt with in" subsection (b).[126] However, *Collier* also acknowledges § 366 does not specifically provide that subsection (b) is inapplicable in chapter 11 cases.[127]

"Subsections (b) and (c) are not mutually exclusive."[128] It is conceptually possible for the debtor to comply with both or for the utility to resort to either. Under subsection (b), for example, the utility may terminate services if the debtor does not offer adequate assurance of payment within twenty days.[129] The debtor is then afforded a ten-day respite.[130] The utility may terminate services under subsection (c), however, if by the end of the ten-day period the debtor has not provided adequate assurance of payment that satisfies the requirements of subsection (c).[131]

Nevertheless, such a procedure may seem impractical.[132] Suppose, within the first twenty days, the debtor tenders adequate assurance of payment in accordance with the more lenient provisions of subsection (b). Note this could include providing an administrative expense priority. The utility would be left

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[124] *See In re* Astle, 338 B.R. 855, 859 (Bankr. D. Idaho 2006).

[125] *Cf.* H.R. REP. NO. 109-31, at 89 (2005), *as reprinted in* 2005 U.S.C.C.A.N. 88, 155 (merely summarizing the amendments to § 366).

[126] 2 COLLIER ON BANKRUPTCY § 366.03 (Alan N. Resnick & Henry J. Sommer eds., 15th ed. rev. 2004).

[127] *Id.*

[128] *Lucre*, 333 B.R. at 155.

[129] 11 U.S.C.S. § 366(b) (2006); *Lucre*, 333 B.R. at 155.

[130] 11 U.S.C.S. § 366(c).

[131] *Id.*

[132] Levin & Ranney-Marinelli, *supra* note 74, at 609 (providing two types of assurance within first thirty days does not seem practical).

to seek modification of what the debtor has furnished under subsection (b).[133] Within the next ten days, the debtor must effectively produce "the stricter cash form of assurance."[134] Reducing this approach to its logical yet absurd conclusion, a debtor could provide adequate assurance and move for a hearing under subsection (b) within the first twenty days; the court could look to subsection (b) to determine adequate assurance of payment and bind the utility for the remainder of the bankruptcy case.[135] Thus, the debtor could choose to circumvent subsection (c) altogether.

Although this was apparently the approach adopted by the *Lucre* court,[136] the *Collier* assertion that subsection (c) applies to the exclusion of subsection (b) in chapter 11 cases seems to be the interpretation that better carries out the intention behind § 366 for two reasons. First, the debtor would otherwise face the burden of producing adequate assurance of payment twice within thirty days. This thwarts the rehabilitative function of § 366. Second, the utility would be forced to accept an undesirable form of assurance within the first twenty days or even throughout the bankruptcy case. This result would undermine the utility's interest and eliminate all of the increased protection Congress obviously intended to give utilities through BAPCPA.

The better approach, which would be consistent with bankruptcy court decisions pre-BAPCPA, would be to conclude only subsection (c) applies in chapter 11 cases. The court could thereafter balance the interests of debtor and utility consistent with the purpose of § 366. As discussed in the remainder of this Article, the courts will likely do this by reading a good faith requirement into subsection (c).

## IV. READING GOOD FAITH INTO SUBSECTION (c)

### A. *Congressional Intent*

In examining whether there is a good faith requirement in § 366(c), a logical place to start is Congressional intent. We can infer Congressional

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133 *Lucre*, 333 B.R. at 155.

134 Levin & Ranney-Marinelli, *supra* note 74, at 609.

135 *Cf.* Harner & Black, *supra* note 80, at 37 n.9 ("Given the competing deadlines in §§ 366(b) and (c) of the Code, a prudent debtor arguably should request a hearing no later than 20 days after the petition date.").

136 *See Lucre*, 333 B.R. at 155.

intent by looking at the language of the statute.[137] Section 366(c)(2) provides in relevant part:

> [A] utility referred to in subsection (a) may alter, refuse, or discontinue utility service, if during the 30-day period beginning on the date of the filing of the petition, the utility does not receive from the debtor or the trustee adequate assurance of payment for utility service that is *satisfactory to the utility*.[138]

At first glance, it would appear the highlighted language gives the utility complete discretion in deciding whether it will accept a debtor's offer of assurance of payment, and therefore, unilateral authority in deciding whether it will discontinue service thirty days after the filing date.[139] Such an interpretation, however, would be completely inconsistent with the purpose of § 366. As detailed above, Congress enacted § 366 to strike a balance between a debtor's need for rehabilitation and the business needs of a utility.[140] To give the utility unilateral authority without qualification to discontinue service after thirty days would be to shift the balance of power almost completely in favor of utilities. If a utility were intent on discontinuing service after thirty days, there would be nothing a debtor could do to stop it. In such a case, the protections of § 366 would be practically useless to a debtor because there is little rehabilitation that can be accomplished in thirty days.

A more reasonable interpretation of § 366(c) is it was intended to shift the balance of power less radically in favor of utilities. Reading § 366(c) to require a utility to negotiate in good faith with a DIP or trustee would be consistent with this interpretation. Such a requirement would enable courts to give utilities deference in the negotiation process, but also prevent utilities from refusing to negotiate or making unreasonable demands in the negotiation process.141

The language of § 366(c) itself suggests Congress may have wanted utilities to negotiate in good faith with DIPs. Section 366(c)(1) provides:

> (A) For purposes of this subsection, the term 'assurance of payment' means—

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[137] As discussed above, the legislative history sheds no light on the Congressional intent underlying the amendment to § 366. *See supra* note 74.

[138] 11 U.S.C.S. § 366(c)(2) (2006) (emphasis added).

[139] *See id.*

[140] *See supra* Part I.

[141] See *infra* Part IV.D for a discussion of tests courts may implement to test the good faith of a utility.

(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.

(B) For purposes of this subsection an administrative expense priority shall not constitute an assurance of payment.[142]

If Congress did not intend to require utilities to negotiate in good faith, § 366(c)(1)(B) would seem to be extraneous. That provision explicitly states an administrative expense priority shall not constitute an assurance of payment.[143] Yet if utilities had complete discretion to reject an offer of assurance of payment, such a provision would be unnecessary. The fact that an administrative expense priority does not fall into any of the classifications of § 366(c)(1)(A)(i)-(v) would mean the only way it could constitute an adequate assurance of payment would be if the utility agrees to voluntarily accept it as such. The utility's flat refusal to do so would be consistent with the utility satisfaction language. Nevertheless, Congress apparently felt it necessary to clarify such refusal is permitted. To avoid being surplusage, subsection (c)(1)(B) must be read to be consistent with an implied good faith requirement.[144] In other words, subsection (c)(1)(B) ensures a court may not find a utility has failed to act in good faith by flatly rejecting a debtor's offer of an administrative expense priority. Of course, Congress may have included subsection (c)(1)(B) to ensure utilities did not voluntarily accept an administrative expense priority as adequate assurance of payment, but this would suggest Congress was trying to protect utilities from themselves and there does not appear to be any evidence of this.[145]

It also does not appear § 366(c)(1)(B) exists only to prevent courts from imposing an administrative expense priority on utilities as a modification of assurance of payment under § 366(c)(3). Section 366(c)(3)(A) provides:

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[142] 11 U.S.C.S. § 366(c)(1).

[143] *Id.* § 366(c)(1)(B).

[144] *See* TRW, Inc. v. Andrews, 534 U.S. 19, 31 (2001) ("It is a cardinal principle of statutory construction that a statute ought, upon the whole, to be so construed that, if it can be prevented, no clause, sentence, or word shall be superfluous, void, or insignificant." (internal quotations omitted).).

[145] Further, such a reading would run contrary to the interests of the utilities that obviously wielded great influence over the amendments to § 366. *Cf.* Fishman, *supra* note 74, at 81 (amendment reflects "influence of utilities").

> On request of a party in interest and after notice and a hearing, the court may order modification of the *amount* of an assurance of payment under paragraph (2).[146]

A court may modify only the *amount* of an assurance of payment, not the *form*.[147] Thus, § 366(c)(3)(A) would not permit a court to impose an administrative expense priority as a form of assurance of payment on a utility where it had not agreed to the form in the first place.[148] Therefore, the threat of modification does not explain why § 366(c)(1)(B) is necessary.

On the other hand, if there is a good faith requirement in § 366(c), a utility presumably could be forced to accept forms of assurance of payment that did not fall into any of the classifications of § 366(c)(1)(A)(i)-(v) if a court were to find the utility did not negotiate in good faith.[149] It would then be necessary for Congress to spell out any forms of assurance of payment that it did not want courts imposing on utilities. The inclusion of § 366(c)(1)(B) would make sense in this case to ensure an administrative expense priority was not one of the forms of assurance of payment forced on utilities. Thus, the most rational reading of § 366(c) adhering to the rules of statutory interpretation is consistent with a requirement that utilities negotiate in good faith.

### B. *Other Instances of Good Faith in the Bankruptcy Code*

There are other instances where courts have interpreted Bankruptcy Code provisions to include good faith components even though the provisions themselves lack an explicit good faith requirement. The most notable example of this is the judicial interpretation of § 1112(b).[150] Section 1112(b), pre-BAPCPA, allowed a court to convert or dismiss a chapter 11 case "for cause."[151] Section 1112(b) did not define "for cause," but listed ten instances

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[146] 11 U.S.C.S. § 366(c)(3)(A) (emphasis added).

[147] *See id.*

[148] *See In re* Lucre, Inc., 333 B.R. 151, 156 (Bankr. W.D. Mich. 2005).

[149] This would be especially likely given Congress has made it clear with its inclusion of § 366(c)(1)(A)(vi) that alternative forms of assurance of payment are acceptable. *See* 11 U.S.C.S. § 366(c)(1)(A)(vi).

[150] Like § 366, § 1112(b) has recently been amended under BAPCPA. The references to § 1112(b) in this Article are to the pre-BAPCPA version for the simple reason case law interpreting former § 1112(b) exists whereas none yet exists for the new law. Forecasting the future judicial interpretation of § 1112(b) is beyond the scope of this Article. The fact that § 1112(b) has been amended does not affect the discussion because the purpose of the discussion is to examine how courts have interpreted Bankruptcy Code provisions.

[151] 11 U.S.C. § 1112(b) (2000).

where cause existed to convert or dismiss.[152] These included a debtor's "inability to effectuate a plan,"[153] "unreasonable delay by the debtor that is prejudicial to creditors,"[154] and "material default by the debtor with respect to a confirmed plan."[155] None of the ten examples mentioned good faith. Most courts, however, interpreted § 1112(b) to include dismissal due to a debtor's lack of good faith in filing the case.[156]

Another Bankruptcy Code provision for which courts have implied a good faith requirement is § 706(a). Section 706(a) deals with a chapter 7 debtor's right to convert the case to another chapter.[157] It provides:

> The debtor may convert a case under this chapter to a case under chapter 11, 12, or 13 of this title at any time, if the case has not been converted under section 1112, 1208, or 1307 of this title. Any waiver of the right to convert a case under this subsection is unenforceable.[158]

While the language of § 706(a) appears at first glance to give the debtor an absolute right to convert the case if it has not previously been converted, some courts have concluded a request for conversion may be denied for a debtor's lack of good faith.[159]

In both of these examples, the requirement to act in good faith has been imposed on the debtor, not creditors, as would a good faith requirement in § 366(c). There are, however, examples in the Bankruptcy Code where

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152 *Id.* § 1112(b)(1)–(10).

153 *Id.* § 1112(b)(2).

154 *Id.* § 1112(b)(3).

155 *Id.* § 1112(b)(8).

156 *See, e.g.*, *In re* SGL Carbon Corp., 200 F.3d 154, 162 (3d Cir. 1999); Trident Assocs. v. Metro. Life Ins. Co. (*In re* Trident Assocs.), 52 F.3d 127, 130–31 (6th Cir. 1995); Marsch v. Marsch (*In re* Marsch), 36 F.3d 825, 828 (9th Cir. 1994); Carolin Corp. v. Miller, 886 F.2d 693, 700 (4th Cir. 1989); Little Creek Dev. Co. v. Commonwealth Mortgage Corp. (*In re* Little Creek Dev. Co.), 779 F.2d 1068, 1071–72 (5th Cir. 1986). It is irrelevant § 1112(b) provides a non-exhaustive list of examples of "cause" while § 366(c) provides an exhaustive list of what constitutes "assurance of payment." We do not contend courts will be adding good faith to a list; we concede this would likely be an abuse of discretion given the list of items that constitute adequate assurance appears to be exhaustive. Rather, we believe good faith is a requirement underlying the entire list and particularly subsection (c)(1)(A)(vi). The analogy is drawn to illustrate that a good faith requirement may be imposed even where not explicitly written into the Bankruptcy Code.

157 *See* 11 U.S.C. § 706(a).

158 *See id.*

159 *See, e.g.*, Copper v. Copper (*In re* Copper), 426 F.3d 810, 816 (6th Cir. 2005); Marrama v. Citizens Bank of Mass. (*In re* Marrama), 430 F.3d 474, 481 (1st Cir. 2005).

standards of good faith behavior have been imposed on creditors.[160] While these examples are explicit Bankruptcy Code provisions, they demonstrate good faith conduct is not only required of debtors but also of other entities in bankruptcy as well.[161] For example, § 1126(e), which deals with an entity's acceptance or rejection of a chapter 11 plan, provides:

> On request of a party in interest, and after notice and a hearing, the court may designate any entity whose acceptance or rejection of such plan was *not in good faith, or was not solicited or procured in good faith* or in accordance with the provisions of this title.[162]

Likewise, § 303(i), which deals with a debtor's right to judgment against a petitioning creditor in an involuntary case, provides:

> If the court dismisses a petition under this section other than on consent of all petitioners and the debtor, and if the debtor does not waive the right to judgment under this subsection, the court may grant judgment—
>
> (1) against the petitioners and in favor of the debtor for—
> (A) costs; or
> (B) a reasonable attorney's fee; or
>
> (2) against any petitioner that filed the petition *in bad faith,* for—
> (A) any damages proximately caused by such filing; or
> (B) punitive damages.[163]

Thus, it is well established creditors can be required to act in good faith in bankruptcy.

*C. Good Faith Requirements Imposed on Utilities at the State Level*

In determining whether a good faith requirement should be read into § 366(c), it is useful to examine how utilities have been regulated by state governments. Although the provisions of § 366 preempt state law by virtue of the Supremacy Clause, bankruptcy courts have routinely relied on the evidentiary value of state law in the context of § 366.[164] Examination of state

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160 *See, e.g.*, 11 U.S.C. §§ 303(i), 1126(e).

161 *See id.* §§ 303(i), 1126(e).

162 *Id.* § 1126(e) (emphasis added).

163 *Id.* § 303(i) (emphasis added).

164 *See* Steinebach v. Tucson Elec. Power Co. (*In re* Steinebach), 303 B.R. 634, 642 (Bankr. D. Ariz. 2003) ("Bankruptcy courts are not bound by local regulation in deciding § 366 issues. Nevertheless, those regulations may provide important guidance in determining when utilities face an unreasonable risk of non-

law provides insight into standards of behavior commonly imposed on utilities. The wisdom of reading a good faith requirement can be evaluated for consistency with these standards of behavior.

There are at least a few instances where Congress or federal courts have required utilities to act in good faith.[165] The majority of good faith requirements, however, appear to be imposed at the state level, where much of the regulation of utilities happens. State statutes and regulations mandate good faith behavior in a number of different contexts.[166]

Many states have implemented statutes, codes, or rules that explicitly require utilities to deal with their end users in good faith.[167] For example, New York's Public Service Commission has promulgated rules requiring utilities to negotiate deferred payment agreements with customers in good faith so as to achieve agreements that are fair considering the customer's financial circumstances.[168] Illinois law states it is state policy for public utilities and residential heating customers to deal with each other in good faith.[169] Under California law, electrical, gas, heat, and water corporations must make "every good faith effort" to inform non-subscriber residential users their account is in arrears at least ten days prior to terminating service.[170] In Texas, contracts between natural gas suppliers and agriculture energy users must be negotiated in good faith.[171]

In addition, numerous states have enacted laws requiring utilities to deal in good faith with other entities. In Maine, for instance, all parties must act in good faith in the performance of any contract whereby an electric transmission

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payment." (internal citations omitted)); Hennen v. Dayton Power & Light Co. (*In re* Hennen), 17 B.R. 720, 725 (Bankr. S.D. Ohio 1982) (adequate assurance determination is a federal question for which state law serves evidentiary value). Further, bankruptcy courts have enforced state law requirements where they were not inconsistent with the provisions of § 366. *See* Begley v. Phila. Elec. Co., 760 F.2d 46 (3d Cir. 1985) (enforcing state law notice pre-requisite for utility termination).

[165] *See, e.g.*, 47 U.S.C. § 251(c)(1) (2000) (imposing duty on certain telecommunications carriers to negotiate terms and conditions of interconnection agreements in good faith); S. Pac. Commc'ns Co. v. Am. Tel. & Tel. Co., 740 F.2d 980 (D.C. Cir. 1984) (holding AT&T's regulatory justification defense to a charge it unlawfully maintained monopoly power by engaging in exclusionary interconnection practices only applies if its interconnection decision is both reasonable and made in good faith); MCI Commc'ns Corp. v. Am. Tel. & Tel. Co., 708 F.2d 1081, 1171 (7th Cir.).

[166] *See infra* notes 167–74 and accompanying text.

[167] *See infra* notes 168–70 and accompanying text.

[168] *See* N.Y. COMP. CODES R. & REGS tit. 16, §§ 11.10(a)(1)(i), 14.10(a)(3) (2006).

[169] 220 ILL. COMP. STAT. 5/8-201 (West 2005).

[170] CAL. PUB. UTIL. CODE § 777 (2005).

[171] TEX. UTIL. CODE ANN. § 123.023 (2005).

and distribution utility purchases energy resources.[172] In North Carolina, the utilities commission may order natural gas distribution companies to negotiate in good faith to enter into service agreements with interstate or intrastate pipelines if it is in the public interest.[173] Kansas and Georgia require telecommunications carriers to negotiate interconnection agreements in good faith.[174]

These examples demonstrate states routinely require utilities to act in good faith when it serves the public interest. The examples span all the traditional utility industries covered by § 366: water, gas, electric, and telephone.[175] Moreover, they show many state laws mandate a utility's good faith in the area of negotiations, both with end users as well as with other entities.[176] States have established standards of behavior where utilities are expected to negotiate in good faith. Reading a good faith requirement into § 366(c) would clearly be consistent with these standards of behavior. Courts will likely find guidance in these state law standards as they did other state law provisions pre-BAPCPA.[177]

### *D. What Would a Good Faith Test Look Like?*

If courts decide § 366(c) requires utilities to negotiate in good faith, the issue of how courts will evaluate whether the standard of good faith has been met remains. There are different contexts in which it would be necessary for a court to apply a good faith test. In the first context, a utility refuses or ignores a debtor's offer of adequate assurance in one of the cash equivalent forms of § 366(c)(1)(A)(i)-(v). This was the situation in *Lucre*, where the debtor offered cash deposits as assurance of payment to which the utilities did not respond.[178] In such cases, a determination of whether the utility acted in good faith would appear to be relatively straightforward. A court could simply compare the value of the assurance of payment being offered with the value of

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172 ME. REV. STAT. ANN. tit. 35-A, § 3309 (2005).

173 N.C. GEN. STAT. § 62-36B (2005).

174 GA. CODE ANN. § 46-5-164 (2005); KAN. STAT. ANN. § 66-2003 (2005).

175 *See, e.g.*, CAL. PUB. UTIL. CODE § 777 (2005) (water, gas, electric); GA. CODE ANN. § 46-5-164 (2005) (telecommunications); ME. REV. STAT. ANN. tit. 35-A, § 3309 (2005) (electric); TEX. UTIL. CODE ANN. § 123.023 (2005) (gas).

176 For examples of state laws regulating the utility's relationship with end users, see CAL. PUB. UTIL. CODE § 777 (2005); 220 ILL. COMP. STAT. 5/8-201 (West 2005); TEX. UTIL. CODE ANN. § 123.023 (2005). For examples of state laws regulating the utility's relationship with other entities, see KAN. STAT. ANN. § 66-2003 (2005); ME. REV. STAT. ANN. tit. 35-A, § 3309 (2005); N.C. GEN. STAT. § 62-36B (2005).

177 *See supra* note 163 and accompanying text.

178 *In re* Lucre, Inc., 333 B.R. 151, 156 (Bankr. W.D. Mich. 2005).

services the debtor was seeking to obtain from the utility. If the value was equal to or more than the value of services requested, the utility should be deemed to have rejected the offer in bad faith.

In a second context, a utility refuses a debtor's offer of adequate assurance in a form other than the ones listed in § 366(c)(1)(A)(i)-(v). This will happen in cases where debtors have problems with liquidity and are unable to offer cash or its equivalent. In certain instances, the analysis will remain straightforward. For example, a DIP might offer a lien on property of the estate that is not otherwise subject to a lien or offer a priming lien on property that was subject to existing liens.[179] In such cases, courts could once again compare the value of the lien with the value of services requested. In other cases, however, the proposed assurance of payment might not lend itself so readily to value comparison.

There are also other contexts in which a straight value comparison might not be appropriate. For example, a utility may have made counteroffers the debtor rejected. A court would naturally want to examine these counteroffers when determining if a utility was negotiating in good faith. In instances where a straight value comparison is not feasible, courts will need to think of other ways to determine if utilities have acted in good faith.

*1. Totality of the Circumstances*

Courts may look for ideas in other good faith tests used by bankruptcy courts. For example, in determining if a case should be dismissed under § 1112(b) as a bad faith filing, courts have examined the totality of facts and circumstances to determine whether they support a finding of good faith.[180] While no single fact is controlling, courts have used the following factors in evaluating a debtor's good faith:

> (1) the debtor has one asset;
> (2) the pre-petition conduct of the debtor has been improper;
> (3) there are only a few unsecured creditors;
> (4) the debtor's property has been posted for foreclosure, and the debtor has been unsuccessful in defending against the foreclosure in state court;

[179] *See* 11 U.S.C. § 364 (2000).

[180] *See, e.g.*, *In re* SGL Carbon Corp., 200 F.3d 154, 162 (3d Cir. 1999); Laguna Assocs. v. Aetna Cas. & Surety Co. (*In re* Laguna Assocs.), 30 F.3d 734, 738 (6th Cir. 1994).

(5) the debtor and one creditor have proceeded to a standstill in state court litigation, and the debtor has lost or has been required to post a bond which it cannot afford;
(6) the filing of the petition effectively allows the debtor to evade court orders;
(7) the debtor has no ongoing business or employees; and
(8) the lack of possibility of reorganization.[181]

Courts may choose to adopt a similar totality of the circumstances test in evaluating whether there have been good faith negotiations under § 366(c). The factors considered would obviously differ from those of the good faith inquiry of § 1112(b). Courts may want to consider factors that go to the utility's behavior as well as factors that speak to the substance of any offered forms of assurance of payment. For example, courts may want to consider a utility's willingness to negotiate as well as the risk to which the debtor's proposed assurance of payment exposes the utility.

### 2. *Behavior of Utilities During the Negotiation Process*

Alternatively, courts may want to adopt an approach similar to one used when evaluating whether a creditor has voted in good faith under § 1126(e). Section 1126(e) allows a court to designate a creditor's vote on confirmation of a chapter 11 plan if the vote was not made in good faith.[182] When evaluating whether a creditor has voted in good faith, some courts have looked for facts that, in and of themselves, raised the question of bad faith without getting into whether the plan is confirmable.[183] The party seeking to have the vote disallowed has a heavy burden of proof.[184]

Similarly, in determining whether a utility has negotiated in good faith, courts may choose not to look into the substance of any offers of adequate assurance of payment. Instead, their inquiry would be limited to facts that shed light on the behavior of utilities during the negotiation process. While this approach would be far less debtor-friendly, there would still be instances where it could be helpful to a debtor. For example, in *Lucre*, several utilities

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[181] *See In re Laguna Assoc.*, 30 F.3d at 734; Little Creek Dev. Co. v. Commonwealth Mortgage Corp. (*In re* Little Creek Dev. Co.), 779 F.2d 1068, 1072–73 (5th Cir. 1986).

[182] *See* 11 U.S.C. § 1126(e).

[183] 7 COLLIER ON BANKRUPTCY § 1126.06 (Alan N. Resnick & Henry J. Sommer eds., 15th ed. rev. 2004) (citing *In re* Peter Thompson Assocs., 155 B.R. 20, 22 (Bankr. D.N.H. 1993)).

[184] *Id*. (citing *In re* United Marine, Inc., 197 B.R. 942 (Bankr. S.D. Fla. 1996); *In re* Kovalchick, 175 B.R. 863 (Bankr. E.D. Pa. 1994)).

refused to respond to the debtor's offers of adequate assurance.[185] Such behavior would be unacceptable under this approach. Consequently, this approach would force utilities at least to participate in the negotiation process.

#### 3. *Deferential Substantive Review*

Courts may choose to go the other way and focus more heavily on the substance of an offer than on a utility's behavior in the negotiation process to determine whether the utility has acted in good faith. One possible way would be to use a standard of review that is highly deferential to utilities, similar to the business judgment rule that is highly deferential to the actions of corporate officers and directors.[186] Under such a standard, if a utility rejects an offer of assurance of payment that would have exposed the utility to very low or no risk, a court would deem the utility acted in bad faith. Alternatively, if the rejected offer would have exposed the utility to a small but not insignificant amount of risk, a court would defer to the judgment of the utility and rule it had acted in good faith.

These are only some of the approaches bankruptcy courts could consider. Different tests work better in different contexts. Courts may choose to implement some of the approaches described above or choose to fashion their own tests.

## CONCLUSION

Section 366 was enacted to balance a debtor's need for utility services in its rehabilitation efforts with a utility's legitimate business interests. Any interpretation of the new § 366(c) must be made bearing this in mind. At first glance, § 366(c)'s "satisfactory to the utility" language would appear to vest utilities with the power to unilaterally discontinue service thirty days after a chapter 11 debtor files for bankruptcy.[187] Upon closer scrutiny, however, it seems such an interpretation could not possibly be correct.

Not only would such an interpretation defeat the purpose of § 366 in many instances, it is also inconsistent with the way § 366(c) was drafted. A much

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[185] *In re* Lucre, Inc., 333 B.R. 151, 154 (Bankr. W.D. Mich. 2005).

[186] *See* STEPHEN M. BAINBRIDGE, CORPORATION LAW AND ECONOMICS 243 (2002) (noting one conception of the business judgment rule is it simply raises the liability bar on corporate directors and officers).

[187] *See* 11 U.S.C.S. § 366(c)(2) (2006).

more reasonable interpretation, and one courts are likely to adopt, is that § 366(c) was intended to shift the balance of power less radically in favor of utilities. Consistent with this, a good faith requirement will likely be read into § 366(c). A good faith requirement would be consistent with other Bankruptcy Code provisions as well as the manner in which utilities are treated under state law. More importantly, a good faith requirement would keep one of the original purposes of § 366 intact by providing chapter 11 debtors with realistic means by which they can keep critical utility service and effectively rehabilitate.