Legal

by Chad Stokes

Your utility customer goes bankrupt — now what?

With bankruptcy filings soaring, utilities are increasingly dealing with customers who are behind in their payments or cannot pay at all. Here are a few of the common legal issues you will likely encounter when dealing with a utility customer that has filed for bankruptcy.

When an individual or business files for protection under the bankruptcy laws, an automatic stay is created under 11 U.S.C. §362. This means that creditors may not take any action to collect a debt, which would include terminating utility services because of unpaid pre-petition utility bills.

Both individual and business debtors usually have a continuing need for utility services even after filing a petition for bankruptcy protection. As a result, Congress has enacted specific provisions in the bankruptcy code regulating utility service under 11 U.S.C. §366. Section 366 balances the debtor's need for utility services with a utility's need to be paid for services provided.

Section 366(a) protects the debtor. Under section 366(a), a utility may not alter, refuse, or discontinue service because the debtor has filed for bankruptcy. This provision also prohibits any act that would discriminate against a debtor solely on the basis of a bankruptcy filing. In short, utility services may not be altered or refused because of a bankruptcy filing — at least not within the first 20 or 30 days as discussed below.

On the other hand, Section 366(b)-(c) protects the utility. Under section 366(b)-(c), the utility can alter, refuse, or terminate service if the debtor does not provide "adequate assurance" that future utility services will be paid. In a Chapter 11 case, "assurance of payment" is defined as a cash deposit, a letter of credit, a certificate of deposit, a surety bond, prepayment of utility consumption, or another form of security mutually agreed on by the utility and the debtor. (11 U.S.C. §366(c)(1)(A)). Importantly, 366(c)(1)(B) provides that for Chapter 11 cases, an administrative expense priority does not constitute an assurance of payment, meaning that the debtor must actually make a cash deposit or provide security as adequate assurance. Depending on the size of the debtor, adequate assurance issues can either be nominal or involve hundreds of thousands of dollars.

It should be noted that the timeframe in which the debtor must provide adequate assurance differs depending on the type of bankruptcy proceeding. In most bankruptcies, (other than Chapter 11), the law gives the debtor 20 days after filing to furnish adequate assurance. Chapter 11 proceedings,

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however, extend the deadline to 30 days after filing the bankruptcy petition. If the debtor fails to provide adequate assurance of payment within the appropriate deadline, then service can be altered, refused, or discontinued, subject to any state law requirements. Because of the potential consequences to the debtor, however, caution should be exercised before disconnecting utility service. As a practical matter, disconnection should only take place after consulting with an attorney to make sure that appropriate procedures are followed.

To the extent that there is a dispute about whether an assurance of payment is adequate in a Chapter 11, the court may **not** consider the following factors: (a) the absence of security before the petition date; (b) the timely payment by the debtor before the petition date; and (c) the availability of an administrative expense priority. Therefore, the merits of whether the assurance of payment is adequate must focus on other issues, including the potential risk to the utility, and the consequence to the debtor and the estate.

By knowing the parameters of what the bankruptcy law provides, you can take steps to protect your utility from uncollectible debt and any violation of bankruptcy law.

Finally, utilities have a number of options to mitigate the risk of unpaid debt following a utility customer filing for bankruptcy. As discussed above, a utility may terminate services if adequate assurance of payment is not provided, as specified in sections 366(b)-(c). In addition, after filing for bankruptcy protection, debtors must remain current on their utility bills. Accordingly, utility services may be terminated after a bankruptcy filing if invoices from the date of the bankruptcy petition are not paid. Again, because of the potential consequences to the debtor, and to avoid any violation of the bankruptcy laws, disconnection should be done after consulting with an attorney and pursuant to a utility's standard disconnection procedures under applicable state law.

In summary, utilities are subject to specific requirements during a bankruptcy. The specific requirements, however, will depend upon the particular situation and which bankruptcy chapter you are dealing with (Chapter 7, Chapter 11, Chapter 12, or Chapter 13). By knowing the parameters of what the bankruptcy law provides, you can take steps to protect your utility from uncollectible debt and any violation of bankruptcy law. NWPPA

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