UNITED STATES BANKRUPTCY COURT
WESTERN DISTRICT OF NEW YORK

In re

VOGE, INC. Case No. 95-14337 K

Debtor

MARK J. SCHLANT, Trustee in Bankruptcy for VOGE, INC.

Plaintiff

-vs- AP 97-1093 K

NIAGARA MOHAWK POWER CORPORATION

Defendant

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Before the Court are cross-motions for summary judgment involving the question of how the "ordinary course/industry standards" and "new value" exceptions to avoidance of preferential transfers apply to a transferee that is a heavily regulated public utility which enjoys a protected monopoly. *See* 11 U.S.C. § 547(c).

Initially, the Court wishes to commend counsel on both sides for excellent and spirited argument and written submissions. (Even the hyperbole (and there is enough to go around) is well-placed.)

The summarized facts are as follows: On September 19, 1994, the Debtor, having defaulted on its obligations to Defendant, Niagara Mohawk (hereinafter "the Utility"), entered into a deferred payment agreement ("DPA") with the Utility, whereby the Debtor could catch up on its arrears by paying a lump sum plus a certain dollar amount per month for a certain number of months. At that time, the Debtor owed the Utility $8,571.33. On January 13, 1995, the Debtor defaulted on the DPA. At this point the Debtor's balance had increased to about $12,891.46, but the Utility continued to supply the Debtor's electricity which was necessary to the Debtor's restaurant business.

On February 10, 1995, the Debtor and the Utility entered into a second DPA which also contemplated a lump sum payment followed by monthly installments. On July 17, 1995, the Debtor once again defaulted; the Debtor's total balance was about $24,209.28.

On August 14, 1995, the Utility allowed the Debtor a third DPA on similar terms, but by the end of September, the total amount due was over $30,000. The Utility issued a bill to the Debtor on October 2, 1995 for $13,260 ($8,135 in overdue DPA payments and $5,125 in current charges) and on October 12, 1995, the Debtor defaulted on the third DPA. The Utility demanded payment, and on November 16, 1995, received a check for $13,260.00 from the Debtor, which was applied against a total balance due of $37,701.25. On December 14, 1995, the Debtor filed a Chapter 11 petition which was converted to Chapter 7 on March 22, 1996, at which point the Debtor owed approximately $25,500 to the Utility.

The Chapter 7 Trustee now seeks turnover of the $13,260 payment as a preference under 11 U.S.C. § 547. The parties stipulate that the payment was preferential under § 547(b), and the only issue remaining is whether the payment qualifies for one of the exceptions set forth in § 547(c). As noted at the outset, the "ordinary course/industry standards" exception and the "new value" exception have been pleaded.

In pertinent part, § 547(c) provides that,

> [t]he trustee may not avoid [a preferential transfer]
>
> (1) to the extent that such transfer was -
>
> > (A) intended by the debtor and the creditor to or for whose benefit such transfer was made to be a contemporaneous exchange for new value given to the debtor; and
> > (B) in fact a substantially contemporaneous exchange;
>
> (2) to the extent that such transfer was -
>
> > (A) in payment of a debt incurred by the debtor in the ordinary course of business or financial affairs of the debtor and the transferee;
> > (B) made in the ordinary course of business or financial affairs of the debtor and the transferee; and
> > (C) made according to ordinary business terms . . .

11 U.S.C. § 547(c).

Although there are three facets to the § 547(c)(2) defense, it will collectively be referred to as the "normal course" exception, encompassing both the so-called objective and subjective tests, as well as the requirement that the antecedent debt itself have been incurred in the ordinary course. The "normal course" exception will be examined first.

Heavily regulated public utilities are one of the few categories of "involuntary" creditors, which is to say creditors who have no choice in the matter of becoming a creditor. Other involuntary creditors that readily come to mind are taxing entities, wage earners (and wage earners' affiliates such as employee benefit plans),[1] and victims of tort or crime. It is perhaps by historical accident that of these categories of involuntary creditors, it is only public utilities and tort victims that do not enjoy either a distributive priority under 11 U.S.C. § 507,[2] or some other degree of heightened protection against preference attack, or against discharge in bankruptcy.[3]

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[1]The theoretical ability of an employee to determine whether to "extend credit" to the employer on a day-by-day basis is, of course, of no practical value.

[2]That historical accident may be gleaned from the report of the 1970 Bankruptcy Review Commission where the Commission recommended that the term "antecedent debt," as used in the preference rules, "not include . . . a debt for utilities incurred within three months of the petition." *Report of the Commission on the Bankruptcy Laws of the United States*, H.R. Doc. No. 93-137, 93d Cong. 1st Sess. (1973), *reprinted in* Appendix B, Collier on Bankruptcy, App. Pt. 4(c), at App. Pt. 4-740 (Lawrence P. King ed. 1997). In a note to that recommendation, the Commission commented that "as a result of the definition [of 'antecedent debt'], payments to . . . utilities . . . are not subject to preference attack." *Id., reprinted in* Appendix B, Collier on Bankruptcy, App. Pt. 4(c), at App. Pt. 4-742. Not only was no special protection given to utilities in the resulting Bankruptcy Code, but no priority was granted to them either. Taxes, wage claims, and certain other employment related claims, however, do enjoy a distributive priority. *See* 11 U.S.C. § 507(a)(3), (4), (8).

[3]Criminal restitution payments that are not mere debt collection (such as for bad checks) have been held to be immune from preference attack as a matter of states' rights. *See Becker v. County of Santa Clara (In re Nelson),* 91 B.R. 904 (N.D. Cal. 1988). Furthermore, when the debtor is a natural person, restitution may be nondischargeable, even if prepetition payment might be recoverable. *See* 11 U.S.C. §§ 523(a)(7) and 1328 (a)(3); *Pennsylvania Dept. of Public Welfare v. Davenport*, 495 U.S. 552 (1990); *Kelly v. Robinson*, 479 U.S. 36 (1986). And to the extent that restitution is viewed as a claim by the state (though for the benefit of a victim) a preference avoidance suit might be precluded by the Eleventh Amendment. *See Seminole Tribe v. Florida*, 517 U.S. 44 (1996).

The fact that utilities and some tort victims do not enjoy either a distributive priority or some other priority[4] makes them more vulnerable to preference attack than taxing entities or wage earners, since it often cannot be said of transferees who enjoy a distributive priority that the transfer "enables such creditor to receive more than such creditor would receive if the case were a case under chapter 7 . . . ; the transfer had not been made; and such creditor receive payment of such debt to the extent provided by the provisions" of the Code. *See* 11 U.S.C. § 547(b)(5). In other words, a § 547 preference action is only brought against a preferential transferee that has a distributive priority if there are other unpaid priority claims of equal or higher rank.

That lack of protection has resulted in a substantial body of law addressing the application of preference law to public utilities. Almost without exception, those cases do not treat public utilities differently from any other type of commercial creditor when addressing the "normal course" defense.[5] A notable exception is a decision of the Honorable Carl L. Bucki, of this Court, in the case of *Bulan v. Niagara Mohawk (In re Al Cohen's Rye Bread Bakery, Inc.)*, 202 B.R. 546 (Bankr. W.D.N.Y. 1996). That decision is the only case of which the present writer is aware that addresses the application of preference law to utilities against a background of state statutes or regulations that govern the utilities' collection of account delinquencies.[6]

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[4]Tort claims may be nondischargeable in some cases, but simple negligence, not involving drunk driving, is nearly always dischargeable. *See* 11 U.S.C. § 523(a).

[5]*See, e.g., Fitzpatrick v. Rockwood Water (In re Tennessee Valley Steel),* 201 B.R. 927 (Bankr. E.D. Tenn. 1996); *Kellman v. P.S.E. & G. (In re Jolly "N", Inc.),* 122 B.R. 897 (Bankr. D. N.J. 1991).

[6]A limited search suggests that only a few states, typically in the colder regions of the Nation where a lack of electricity is known to result in deaths by hypothermia, have such regulations. *See, e.g.*, 220 Ill. Comp. Stat. Ann. 518-206 (West 1997); Utah Admin. Code R746-200-6)G)(1)(C)(1997); Wis. Admin. Code § PSC 134.0624 (1997).

There this Court discussed a New York State regulation adopted in 1987, that commands that a utility advise a delinquent customer of its eligibility for a deferred payment arrangement before that utility may proceed with any termination of service for nonpayment of arrears.[7] Bankruptcy Judge Bucki concluded, and this writer fully agrees, that adherence to state law regarding the collection of delinquencies by a utility constitutes a complete defense to a preference action. Addressing the Second Circuit decision in the case of *Lawson v. Ford Motor Co. (In re Roblin Industries),* 78 F.3d 30 (2d Cir. 1996), Bankruptcy Judge Bucki emphasized that the deferred payment arrangement for utility obligations is not only the "ordinary course of business," but it

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[7]The regulation provides that:

> (1) A utility shall provide a written notice offering a deferred payment agreement in accordance with this section to an eligible customer at the following times:
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> (i) not less than five calendar days before the date of a scheduled termination of service for nonpayment of arrears, as indicated on a final termination notice, or eight calendar days if mailed, provided the customer has been a customer for at least six months and the arrears on which the outstanding termination notice is based exceed two months' average billing; and
>
> (ii) when it renders a back bill, which exceeds the cost of twice the customer's average monthly usage or $100, which ever is greater; provided, however, that a utility shall not be required to offer an agreement when the customer knew, or reasonably should have known, that the original billing was incorrect.
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> (2) If a utility and a customer agree to terms of a deferred payment agreement in a telephone conversation, the utility shall send the customer two fully completed copies of the agreement, signed by the utility, for the customer to sign and return.
>
> (b) *Eligibility.* (1) Any customer is eligible for a deferred payment agreement except the following:
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> (i) a customer who owes any amounts under a prior deferred payment agreement;
>
> (ii) a customer who failed to make timely payments under a prior deferred payment agreement in effect during the previous 12 months; . . .

N.Y. Comp. Codes R. & Regs. tit. 16, § 13.5(a)-(b)(ii) (1995) (filed Sept. 22, 1987).

is, moreover, "universally available in New York State for all eligible customers. Such deferred payments, therefore, are necessarily made according to ordinary business terms." *Al Cohen's*, 202 B.R. at 549.

I would add to his analysis only the fact that this satisfies both the so-called objective and subjective elements of the defense. In the *Roblin Industries* case, the Second Circuit addressed the objective test and favorably cited the case of *In re Tolona Pizza Products Corp.,* 3 F.3d 1029 (7th Cir. 1993), wherein it was stated that "ordinary business terms" refers to the general practice of similar industry members, and that "only dealings so idiosyncratic as to fall outside that broad range should be deemed extraordinary and therefore outside the scope" of the exception that is provided for transactions made under ordinary business terms. *Tolona Pizza*, 3 F.3d at 1033. In my view, a utility company's compliance with a duly enacted regulation of the state, applicable to that utility in the locale which that utility serves, can never be viewed as "idiosyncratic." As to the subjective test, I find that even though a DPA definitely alters the "ordinary course" of dealing between a utility and a debtor, it is predictably and mandatorily so, such as to constitute the "ordinary course" as between any debtor and a utility.

There is, however, a twist in the facts in the case at Bar. Here not only did the Utility offer, and the Debtor avail itself of, the deferred payment option required by regulation, but there were defaults in the resulting arrangement, and those defaults were the subject of yet further arrangements and continued electric service in excess of what the regulations required.[8]

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[8]Indeed, under the regulations the Debtor was ineligible for further deferred payment agreements. *See supra* note 7.

These and further arrangements do not fall within the ambit of the complete defense described above, and would have to survive the same analysis that applies to voluntary, rather than involuntary, extenders of credit.

As noted above, there is a great deal of case law applying the usual preference defenses in the case of preferential payments to utilities where no statute or regulation defines the normal course that a utility must follow. It is the usual principles that must be applied here to the extent that the Utility departed from the regulatory scheme, and I find inescapable the conclusion that the departure took the \$13,260 payment outside the "ordinary course" as between the Debtor and the Utility.

However, as to the "new value" exception it appears to the Court that the \$13,260 at issue is completely offset by the value of the electric service provided by the Utility past the point that law required it, and that remains unpaid. This would seem to resolve the matter, but the Court will address a further argument made by the Utility, that seems to argue for a new, judge-made exception to preference attack, just for utilities.

It is argued that applying regular preference standards would "punish" a utility for going to every length to avoid a termination of service, and would promote termination of service. This is a bit overwrought. Under 11 U.S.C. § 547(b), a utility will never be ordered here to disgorge any portion of the payment it received for the value of services that it provided as a matter of good will or patience beyond that required by state law. We are not dealing, here, with whether a utility will or will not be made whole for such services. 11 U.S.C. § 547 only deals with amounts already paid, and that statute can never cause a utility to "lose" by electing to continue service as long as it receives payment for the ongoing services.

Indeed, the use of the word "punish" in connection with 11 U.S.C. § 547 is almost always misplaced. The worst that could happen is disgorgement of *amounts not offset by the value bestowed by extending more credit.* If "new value" is properly claimed in the defense (as it was here), continuing to help the debtor survive will always turn out to have been at least a "win/break-even" proposition, if not a "win/win" situation, where a preferential payment was involved.

By electing to continue service, a Utility may profit and will profit if that continuation enables the customer to rebound. It may be that many customers do rebound (whether they invoke the protection of this Court or not), who would not have rebounded if electricity were to be terminated. And a rebound means collection by the utility of past due amounts that would not have been collected. Surely, a utility may lose if it continues service without some payment on account, but that has absolutely nothing to do with the law of preferences. So long as it provides services after a payment on the account is made, the law of preferences is nothing to fear.

Lastly, the Utility here speaks of a decision not to terminate service past the point of the regulatory DPA as "forbearance." That terminology is a rocky road that we need not travel,[9] for the present case may be easily analyzed without ever using a word like forbear,

[9]It was well-explored by Chief Bankruptcy Judge Brozman in *In re Maxwell Newspapers, Inc.*, 192 B.R. 633, 636, 637 (Bankr. S.D.N.Y. 1996). Judge Brozman concluded that forbearance that augments the estate is "new value" and is different from "mere forbearance" that does not do so. There, as here, the court dealt with a continuing service, *i.e.*, insurance coverage, and the court correctly distinguished the continuation of service from a mere decision not to sue, for example.

tolerate, refrain, forgive, or the like. The decision of the Utility at each step was simply a decision to continue to provide a service to the Debtor on a credit basis. This is no different than the willingness of a supplier of fresh poultry to do the same. When we speak of that creditor's decision to continue selling to the debtor on a credit basis, we do not say that the creditor is "forbearing" from a decision to tell the debtor to shop elsewhere.

Although the "quantity" of new value conferred by the decision to continue electric service might be assessed differently from that conferred by the trade supplier's decision (unless the trade supplier too had a monopoly and could put the debtor out of business), the decisions of the two creditors are qualitatively the same, and neither of them is rightly said to have engaged in "forbearance" in a § 547, "new value" sense.

To avoid confusion with the true "forbearance" cases, then, I uniformly refer to the Utility's actions here as a continuation of services on credit terms. Stated as such, it is unequivocally "new value," and the Utility is entitled to an offset for any such prepetition services that remain unpaid.

In light of the above, it seems that the $13,260 payment attacked here (however it might have been apportioned on the bill) did not make the Defendant whole for electric services provided past the point required by law. If that is true, then this action is at an end since the offset for unpaid "new value" exceeds the amount in controversy. If not, it must continue, and further examination of the "ordinary course" defense is available. In so ruling, the Court does not foreclose exploration of a "new value" theory that involves the interesting question of the respective "quantity" of "new value" provided by the monopolistic utility as compared to the trade creditor without such control over the fate of a debtor. In other words, is a utility's decision to provide continued service worth more than just the value of the subsequent services provided? Loss of electricity brings a whole restaurant down. A kingdom may be lost for want of a nail. What, then, is the value of the nail, provided on credit terms, by a supplier who has just received a preferential payment?

CONCLUSION

If any portion of the challenged $13,260 payment was made by the Debtor to the Utility in accordance with a deferred payment arrangement that complied to the letter with the governing regulation, then that is protected by the § 547(c)(2) defense. Additionally, to the extent that the Utility remains unpaid for services used by the Debtor past the point when the Defendant could have terminated service but elected not to, there must be a "new value" offset in favor of the Utility.

To the Court it appears in light of the known facts that one or both of these holdings result in judgment for the Defendant, dismissing the § 547 complaint completely. But if other issues remain, then they should be the subject of a further pre-trial conference under Rule 16.

This adversary proceeding is restored to the Calendar Call of February 18, 1998 at 11:30 a.m. for further scheduling, unless counsel advise Chambers that the matter is resolved, in which event a further Order directing Judgment may be entered accordingly. The time to appeal will not begin until such Judgment is entered.

SO ORDERED.

Dated: Buffalo, New York
February 9, 1998

/s/ Michael J. Kaplan

U.S.B.J.