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Be Careful What You Ask For

Ruling precludes debtors from disallowing expense priority for post-petition utility bills

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Special to the Law Weekly

A New York Bankruptcy Court judge recently ruled against a Chapter 11 debtor in a dispute with two of its public utilities.

On March 19, 2003, Judge Burton R. Lifland held in *In re Bethlehem Steel Co.*, 291 B.R. 260 (Bankr. S.D.N.Y. 2003), that where the debtor had filed a Utilities Motion, pursuant to Section 366(b) of the Bankruptcy Code, proposing as adequate assurance of payment to its utilities that their post-petition invoices be accorded administrative expense priority under Sections 503(b) and 507(a)(1) of the Bankruptcy Code, the Bankruptcy Court issued a Utilities Order granting such relief, then later, after these utilities had provided several months of natural gas to the debtor,

they had sent to the debtor post-petition invoices (with prices set at contract rates), and the debtor paid them in full – for the most part, the debtor could not request that the court reduce the prices in those invoices on the grounds that the market price of natural gas had decreased below the contract prices. As the Utilities Order had accorded administrative expense priority to all of the debtors' utilities, that order was binding thereafter on all parties, and pursuant to the doctrine of judicial estoppel, the debtor later could not seek to undo same.

FACTS

In October 2000, Bethlehem Steel Corporation and its affiliated entities ("the Debtor") entered into two long-term contracts (the "Contracts") with BP Energy and Conoco Phillips Co. (the "Utilities"). Under the Contracts, the Utilities agreed to provide large quantities of natural gas to the Debtor for use at its steel plants and mills. Each contract contained provisions requiring the Utilities to sell and the Debtor to purchase gas at the greater of market value or a specified, floor price; i.e., minimum prices for which the gas would be sold. 291 B.R. 261. The terms of the Contracts expired on Dec. 31, 2002.

On Oct. 15, 2001 (the "Petition Date"), the Debtor filed for Chapter 11 relief with the U.S. Bankruptcy Court for the Southern District of New York.

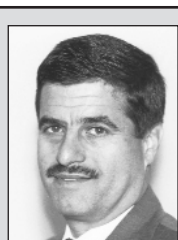
On the Petition Date, the Debtor filed a standard; i.e., meaning standard for a mega-Chapter 11 case such as the

instant one, Utilities Motion pursuant to Section 366(b) of the Bankruptcy Code. In pertinent part, Section 366(b) reads as follows: "[A] utility may alter, refuse, or discontinue service if neither the trustee nor the debtor, within 20 days after the 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."

In the Utilities Motion, the Debtor sought the following relief: to enjoin utilities from terminating service due to its filing for bankruptcy; to enjoin utilities from terminating service altogether; to prohibit utilities from assessing post-petition security deposits; to pay post-petition utility invoices "as billed and when due"; 291 B.R. at 262; and to grant administrative expense priority for undisputed, post-petition utility invoices pursuant to Sections 503(b) and 507(a)(1) of the Bankruptcy Code.

In pertinent part, Section 503(b) provides: "After notice and a hearing, there shall be allowed, administrative expenses, ... including – the actual, necessary costs and expenses of preserving the estate ..."; and Section 507(a)(1) provides: "[t]he following expenses and claims have priority in the following order: First, administrative expenses allowed under section 503(b) of this title ..."

Generally speaking, a trade creditor desires having administrative expenses priority for its post-petition goods and services supplied to a debtor. With such status, the debtor is supposed to pay invoices from such creditors \$1.00 for



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\$1.00 on or before their due dates. This priority is higher than others; e.g., a general unsecured claim, the priority accorded under the Bankruptcy Code to most pre-petition trade creditors' invoices. Frequently, general unsecured claims are not paid \$1.00 for \$1.00 in most bankruptcy cases. But administrative expense priority is lower than creditors granted super-priority status, as are financial institutions providing debtor in possession financing to Chapter 11 debtors. But an administrative expense priority is only a legal priority, and in failed Chapter 11 cases, where debtors' estates become insolvent, invoices even with administrative expense priority may not get paid.

In its ruling, the court issued its Utilities Order, which granted the Utilities Motion.

About five months passed. The Utilities provided gas to the Debtor, they invoiced the Debtor therefore, with the price terms set pursuant to the pre-petition contracts between the parties. Subject to minor exception, the Debtor paid these post-petition invoices without dispute.

Then the Debtor filed a motion with the Bankruptcy Court seeking to reject the Contracts; i.e., to permit both sides to stop performance thereunder, on the grounds that the market price for natural gas was much lower than the floor prices in the Contracts. Generally speaking, the standard for authorization of a debtor's motion to reject an executory contract (one in which post-petition, there are continuing obligations on both parties to perform) is 'the best business judgment' of the debtor. As characterized by this court, a debtor is permitted to reject those executory contracts which are unprofitable to the estate. 291 B.R. at 264. As it was the Debtor who had filed the motion, the Bankruptcy Court accepted the Debtor's business judgment concerning the Contracts. It granted this motion by order, dated May 9, 2002 (the "Rejection Order"). The Utilities appealed. The Rejection Order permitted the termination of the Contracts retroactively, effective back to March 5, 2002 (the "Effective Date"). By order, dated Nov. 14, 2002, the District Court affirmed the Rejection Order. 291 B.R.

293.

But the Debtor was not finished with the Utilities. On June 25, 2002, it filed a complaint against them with the Bankruptcy Court. It sought the following relief: (a) the amount of the administrative expense claims of the Utilities for unpaid charges prior to rejection of the Contracts be limited to the lower market price for natural gas instead of the higher floor prices set in the Contracts; (b) the Utilities be directed to refund to the Debtor's estate the amount by which the floor price in the Contracts exceeded the market price, and with interest; (c) the post-petition overpayments be avoided as unauthorized post-petition transfers; and (d) requiring the Utilities to pay the Debtor interest on the overpayments. The totals of the alleged overpayments under the Contracts between the Petition Date and the Effective Date were \$2.3 million and \$2.6 million, respectively. The Debtor sought refunds thereof from the Utilities. The Debtor moved for summary judgment for the relief sought in its complaint. 262 B.R. at 263.

The Utilities filed their own cross motions for summary judgment. They sought two alternative forms of relief: (a) to require the Debtor to pay the contract price for the natural gas provided post-petition between the Petition Date and the Effective Date; or (b) to deem the post-petition payments made by the Debtor to the Utilities to be settlement payments pursuant to special provisions of the Bankruptcy Code pertaining to commodities contracts or forward contracts, which they were entitled to keep. 262 B.R. at 263. These are extremely complex and rarely-invoked provisions of the Bankruptcy Code. As the court ultimately adjudicated the dispute upon other grounds, it did not rule upon these issues. 264 B.R. at 264 to 265.

DISCUSSION

A. Grounds for Summary Judgment Were Present

Preliminarily, the court, citing *Celotex Corp. v. Catrett*, 477 U.S. 317, 322 (1986), and *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 246 (1986), established the grounds for the granting of a motion for summary judgment

under Rule 56(c) of the Federal Rules of Civil Procedure: when the pleadings, discovery, and affidavits show that there are no genuine issues of material fact requiring resolution and the movant is entitled to judgment as a matter of law, as no reasonable fact-finder could find in favor of the non-movant. 262 B.R. at 264.

B. Administrative Expense Priority Granted to Non-Debtor in Post-Petition Period Prior to Effective Date of Assumption/Rejection

After reviewing the general principle as to executory contracts; i.e., the Bankruptcy Code is designed to permit a debtor to assume profitable contracts and to reject unprofitable ones, the court recognized the rule about the priority of payment for post-petition invoices issued by the other party prior to the effective date of a debtor's decision to assume or reject: "the contract is entitled to payment as an administrative expense." 262 B.R. at 264, citing *inter alia*, *In re Orion Pictures Corp.*, 4 F.3d 1095, 1098 (2nd Cir. 1993), and *In re Wedtech Corp.*, 72 B.R. 464, 467 (Bankr. S.D.N.Y. 1987).

However, Section 503(b) limits those expenses entitled to administrative expense priority only to those which are the "actual and necessary cost of preserving the estate." 262 B.R. at 264. Where there is a contract, such as the Contracts here, there is an initial assumption that "the contract rate is the reasonable value of the goods or services provided to the estate." *Id.*

This assumption is rebuttable only upon a showing by the debtor of "convincing evidence to the contrary". *Id.*

The key arguments advanced by the Utilities was that due to the prior issuance of the Utilities Order and the Debtor's actions post-petition prior to the Effective Date, the Debtor had waived its right to relitigate the priority of payment of the post-petition invoices, and the Debtor was estopped from a later ruling that these invoices could have any priority other than as administrative expense – and at the prices established in the Contracts.

The court agreed with the Utilities.

C. Grounds for Judicial Estoppel Existed

First, the court recognized that at its

core, a Bankruptcy Court is “a court of equity ... [I]t applies the principles and rules of equity jurisprudence, including principles of estoppel.” 262 B.R. at 265.

Second, citing a long litany of Second Circuit jurisprudence, including *In re Ionosphere Clubs, Inc.*, 85 F.3d at 999 (2nd Cir. 1996), and *Readco, Inc. v Marine Midland Bank*, 81 F.3d 295, 301 (2nd Cir. 1996), the court ruled that the assertion of a legal right by a debtor which is inconsistent with its prior words or acts is improper, where a non-debtor has relied thereupon; and further, where a party has advanced an inconsistent factual position in a prior proceeding, which the court has adopted in some fashion, then “that party is judicially estopped from asserting the inconsistent position.” 291 B.R. at 295.

Here, the Debtor previously had advanced in the Utilities Motion a case for *why* its utilities, including the

Utilities with their Contracts, should be accorded administrative expense priority for their post-petition services: utility services were “essential to the Debtor’s business operations and that any interruption in service would substantially diminish or eliminate the Debtor’s chances for a successful reorganization.” 291 B.R. at 295. This was satisfaction of the very standard for the granting of administrative expense priority to utilities. In the Utilities Motion, the Debtor further recited its past history of prompt and full payment of outstanding utility invoices. At no time were the Utilities offered a lesser market rate or to exercise any termination rights which they may have had under the Contracts. *Id.*

Third, to then, later on in the case, seek to undo administrative expense priority and to pay less than the contractual rate for the natural gas delivered, *after* the Utilities had relied upon such prior-

ity by accepting the Utilities Order and not appealing it, this was the essence for adherence to the doctrine of judicial estoppel – especially when coupled with providing the gas during the pre-rejection period and the Debtor’s payment thereof at the full contract rate. 291 B.R. at 266 to 267.

CONCLUSION

That was it for this judge. Granting the Utilities’ motions for summary judgment and denying the Debtor’s, he held that the Debtor was estopped from arguing against the rates set forth in the Contracts. The Utilities were allowed to keep all payments they had received post-petition, and they were granted administrative expense priority at the rates set forth in the Contracts for all gas delivered post-petition but not yet paid for by the Debtor. 291 B.R. at 267. ■