



# ABI Telecommunications and Technology Committee Newsletter

## *ABI Committee News*

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### **Post-BAPCPA Approaches To §366 Adequate Assurance Motions**

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Motions to determine that utilities are adequately assured of payment pursuant to §366 of the Bankruptcy Code, 11 U.S.C. §366, are common “first day” motions.

Section 366 of the Bankruptcy Code prevents utilities from discontinuing services to a debtor as long as the utilities have received adequate assurance of payment for post-petition services. This article examines the approaches to adequate assurance following the enactment of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA).

#### **Pre-BAPCPA Practice**

Prior to the enactment of BAPCPA, utilities were prohibited from terminating services post-petition to a debtor on the basis that a debtor had filed for bankruptcy protection or that pre-petition services were not paid when due. In order to qualify for the statutory injunction, a debtor was only required to furnish adequate “assurance of payment” within 20 days of the filing of the bankruptcy case to qualify for the statutory injunction. The Bankruptcy Code did not define “assurance of payment.”

In a complex chapter 11 case, a debtor would file an adequate assurance motion as part of its first-day motions and

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offer a fairly standard list of non-monetary assurances of payment such as the debtor's consistent pre-petition payment history, entitlement to administrative claim priority and the existence of pre-petition deposits. As justification, the debtor would rely on *Virginia Elec. and Power Co. v. Caldor Inc.*, 117 F.3d 646 (2d Cir. 1997) which held that an administrative expense, without more, could constitute adequate assurance in certain cases.

If a utility was not satisfied with the debtor's proposed adequate assurance, the burden rested with the utility to seek a modification of the adequate assurance. Utilities insisted that some form of security was required and often requested one- to two-month deposits. Absent security, the utilities argued, they would be forced to finance the chapter 11 case and bear the risk of nonpayment should the debtor become administratively insolvent. Often, the utilities would manage to negotiate a deposit of two weeks to one month. Those utilities that took no action, however, only received the adequate assurances offered in the motion.

### **BAPCPA Amendments to §366**

BAPCPA amended §366 specifically to shift the balance of power in favor of the utilities. Most importantly, §366(c)(1) defined the phrase "assurance of payment" by listing examples of security such as cash, letters of credit, certificates of deposit, surety bonds and prepayment for services. Section 366(c)(1) was further amended to unequivocally state that an administrative expense claim is not an assurance of payment.

Section 366 was also amended to address the process by which adequate assurances would be determined. Section 366 (b) still requires the debtor to make an offer of adequate assurance within the first 20 days. If a utility does not receive adequate assurances satisfactory to the utility within 30 days, however, §366(c)(2) allows the utility to discontinue service. At least at the outset of a case, §366(c)(2) appears to allow a utility the unfettered ability to demand and receive whatever adequate assurances it deems appropriate. Only after acceding to a utility's demands is a debtor entitled to have the court modify the adequate assurances pursuant to §366(c)(3).

### **Post-BAPCPA Practice**

A review of a sample of post-BAPCPA cases found one approach, offering two-week deposits, to be the most common post-BAPCPA method of offering adequate assurance. There were other cases that employed different approaches to adequate assurance, such as payment of pre-petition bills, pre-payment for post-petition services and the use of blocked

accounts in lieu of deposits. Success often depends on how aggressive the approach is. The more aggressive the approach, the more likely it becomes that utilities will contest a debtor's proposal and demand greater assurances. In those instances, utilities have generally prevailed in their adequate assurance demands.

### **Two-Week Deposit**

By far the most common post-BAPCPA approach has been to offer utilities a two-week deposit. Cases that have employed this approach are fairly evenly divided between automatically placing the deposits with utilities or paying the deposit only upon a utility's request. While some utilities have filed objections and negotiated additional assurances in some instances, for the most part this approach has not met vigorous opposition from utilities.

### **Payment of Pre-Petition Bills**

In *McLeodUSA Inc.*, Case No. 05-63229 (Bankr. N.D. Ill.), which was a telecommunications case filed shortly after BAPCPA became effective, the debtor's sole proffer of adequate assurance was that they would pay pre-petition bills in the ordinary course of business. The court granted the relief on a final basis as part of the first-day hearing. One utility, which claimed to be the largest unsecured creditor and the major telecommunications provider to the debtor, filed a motion seeking to require the debtors to comply with §366. The utility argued that the debtor had completely ignored the new definition of adequate assurance in §366. Rather than litigate, the debtor entered into a stipulation with the utility, which excepted the utility from the first-day order and paid a \$4.5 million deposit.

### **Pre-Payment**

In *In re Pac-West Telecomm Inc.*, Case No. 07-10762 (Bankr. D. Del.), the debtors, who were competitive local exchange carriers, offered a combination of deposits and pre-payments as adequate assurances. Traditional utility service providers such as power and water utilities were offered two-week deposits. Telecommunications service providers were offered two forms of pre-payments depending on the types of charges. For access charges, which were traditionally pre-paid, the debtors offered to continue pre-paying those charges on a monthly basis plus a one-time supplemental pre-payment of an additional one week's worth of charges. Thus, utilities would always be pre-paid between one and five weeks in advance. For usage charges, which were paid in arrears, the debtors offered to pre-pay one month of charges based on prior usage. The debtors further offered to replenish that pre-payment twice per month,

so that the utilities would always be between two weeks to a month pre-paid on those charges. While some of the telecommunications service providers negotiated their own adequate assurance stipulations, all of them accepted the economic terms offered by the debtors.

### **Blocked Accounts**

One innovative approach tried in both *Radnor Holdings Corp.*, Case No. 06-10894 (Bankr. D. Del.) and *In re Tweeter Home Entertainment Group Inc.*, Case No. 07-10707 (Bankr. D. Del.) with varying degrees of success, was the use of blocked accounts. Rather than place security with each utility, the debtors in both cases established blocked accounts with their lenders against which utilities could draw in the event of non-payment. In both *Radnor* and *Tweeter*, the debtors proposed to fund the account in an amount equal to two weeks of the average utility charges, which were \$1 million and \$500,000 respectively (although the interim order entered in *Tweeter* reduced that amount to \$300,000 with no explanation for the reduction).

In *Radnor*, certain utilities moved to vacate the interim utility order, contending it did not comply with §366, as amended, and two other utilities made requests for additional assurances. The utilities were able to leverage deposits out of the debtor, which aggregated more than \$800,000—nearly the entire amount of what had been proposed for all utilities under the blocked account. The deposits were conditioned on the utilities waiving the right to draw on the blocked account.

In *Tweeter*, an even larger group of utilities moved to vacate the interim utility order establishing blocked accounts. The utilities argued for two-month deposits because the debtors were conducting going-out-of-business sales and the utilities would be providing services for an indefinite and potentially lengthy timeframe. At the hearing on the utilities' motions for reconsideration, the debtor announced that it would accede to the two-month deposit requests, but asked the court not to require it to fund the deposits immediately. Instead, having agreed to deposits satisfactory to the utilities under §366(c)(2), the debtors contended they were entitled to file, and would file, a motion seeking to modify the adequate assurance pursuant to §366(c)(3) and would seek to have the court impose two-week deposits. The court agreed to the debtors' request to forego paying the deposits and, shortly thereafter, granted the motion to modify the adequate assurances to two-week deposits.<sup>[1]</sup>

The utilities appealed both the order allowing the debtors to forego paying the deposits while the §366(c)(3) motion was

pending and the order modifying the adequate assurances to two-week deposits. Initially, the debtors resisted the utilities' efforts. However, in the face of the mounting litigation costs, the debtors finally gave in to the utilities' demands and agreed to pay two-month deposits on the condition that the utilities withdraw their appeals.

### **Conclusion**

Examining these post-BAPCPA cases and their approaches to adequate assurance provides several insights. First, most debtors are making more substantial and innovative offers of adequate assurance at the outset of cases than pre-BAPCPA practice. Second, some debtors push the limits of §366 and offer as little as possible. Third, in such cases, if a utility challenges a debtor, the utility has often been able to dictate the terms of adequate assurances.

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The reconsideration motion was heard on Monday July 2; the debtors filed their motion to modify adequate assurances on July 5; the utilities filed their objections that same day; and the court held a hearing on July 6.