Adequate Assurance of Payment Under Section 366 of the Bankruptcy Code: A Term for Interpretive Flexibility or Judicial Confusion?

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ADEQUATE ASSURANCE OF PAYMENT UNDER SECTION 366 OF THE BANKRUPTCY CODE: A TERM FOR INTERPRETIVE FLEXIBILITY OR JUDICIAL CONFUSION?

by

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INTRODUCTION

Bankruptcy is a gloomy and depressing subject. The law of bankruptcy is a dry and discouraging topic. But the history of bankruptcy legislation... is colorful; for not only does it reflect the changes in viewpoints and in economic conditions in our National history, but it also reminds us of how frequently the views and conditions of today are mere repetitions of the past.¹

The preceding words were written by a legal scholar and historian more than 50 years ago and continue to reveal an undeniable truth today. Unfortunately for the parties to bankruptcy, the financially troubled debtor and the unsatisfied creditors, their expectations in bankruptcy will undoubtedly be “gloomy.” Fortunately for the student of the law, the history of bankruptcy as a body of law is at the very least “colorful,” particularly when one considers the fact that our bankruptcy laws have been the subject of Congressional revision, repeal and amendment more than 90 times since the enactment of the first comprehensive Bankruptcy Act of 1898;² one of the most carefully and painstakingly considered statutes to ever get through Congress in its history. This profound amount of legislative attention and activity is most evident of Congressional desire and effort to be responsive to the incessant challenges of the economies of our society. The resulting law has always been consistent in echoing a familiar purpose toward federal bankruptcy procedure and resolution. This purpose is to provide expeditious relief and remedy to the financially distressed debtor while preserving the interests of his creditors fairly and equitably.

A fairly recent example of Congressional responsiveness to a challenge of the remedial and egalitarian objectives of the bankruptcy laws is in section 366 of the Bankruptcy Code.³ Section 366 was added to the mass of federal bankruptcy law through the enactment of the Bankruptcy Reform Act of 1978.⁴ The primary goal of the Reform Act was to resolve various controver-

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¹C. WARREN, BANKRUPTCY IN UNITED STATES HISTORY. 3 (1935).


cies in the bankruptcy court structure, jurisdiction and venue. However, Congress took advantage of this opportunity for legislative revision to respond to a commonplace practice among utility company creditors of coercing bankrupt customers to pay outstanding pre-petition debts under the pressure of threats to terminate utility service and to deny future service. Section 366 was enacted under the Reform Act, and subsequently amended by the Bankruptcy Amendments and Federal Judgeship Act of 1984, to respond to this problem of coercion by proscribing the following:

(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 of the commencement of a case under this title or that a debt owed by the debtor to such utility for service rendered before the order of 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 the date of the order of 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.

Section 366 can be applauded for being a direct answer to the unfair and coercive tactics that were used by utilities. This is achieved through the specific prohibition of service alteration, discontinuance or discrimination because a customer has filed a petition for relief in bankruptcy or because of the outstanding indebtedness of the bankrupt customer. Section 366 is also mindful of the need to protect the interest of the creditor in bankruptcy, which is achieved through the requirement that the debtor or his representative provide the utility with some security or "adequate assurance of payment" for future service. Another positive characteristic of section 366 is the fact that it is "self-executing," that is, the utility requesting or the debtor providing an adequate assurance of payment may do so without instituting any formal proceeding. The only time in which a formal proceeding becomes necessary is when one of

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5 The language "the commencement of a case under this title or" was added to subsection (a) of section 366 pursuant to the Bankruptcy Amendments Act of 1984. Prior to this amendment, subsection (a) only prohibited discriminatory conduct by the utility against the debtor solely because of the debtor's outstanding pre-petition debts. This amendment expands subsection (a) to prohibit discrimination against the debtor solely because of the debtor's pre-petition indebtedness or because the debtor has filed a petition in bankruptcy.
6 2 Collier on Bankruptcy, ¶ 366.03 at 366-3 (15th ed. 1984). Prior to the enactment of section 366, issues concerning the extent to which a utility could demand payment of pre-petition indebtedness from bankrupt customers was determined solely by the courts due to the lack of a specific provision under the Bankruptcy Act of 1898 addressing the claims of a utility against its customer in bankruptcy.
the parties to the bankruptcy believes that the security requested or provided is unreasonable and needs modification. A party’s right to a formal hearing on the reasonableness of the adequate assurance of payment for future services is provided for under subsection (b) of section 366.

Despite the fact that section 366 is both self-executing and relatively clear in its purposes and intents, it has been the subject of much litigation calling for judicial interpretation of certain terms and phrases that are not expressly defined in section 366 or elsewhere in the Code, and for clarifications of the conduct intended to be regulated thereunder. The several cases requiring judicial interpretation and clarification have focused on the following issues:

1) the meaning of the term “utility” under section 366 and the kinds of creditors that were intended to fall within the scope of utility under section 366;

2) the applicability of the section 366 prohibition in cases where a utility terminates or alters services to a debtor with pre-petition debts, but for reasons other than the debtor’s pre-petition indebtedness;

3) whether the existence of some pre-petition indebtedness by the debtor is a criterion that must exist in order for the utility to be entitled to adequate assurance of payment for future services under section 366; and

4) what constitutes adequate assurance of payment for future services.

The various courts that have dealt with these issues have set forth clear and relatively consistent interpretations of the first three issues mentioned above. However, the issue of what constitutes an adequate assurance of payment for future services has not been as consistent or clear. Because the phrase “adequate assurance of payment” is not defined under the Code, the entire task of giving meaning to this phrase is left to the reasonable discretion of the courts to allow for judicial flexibility in making such determinations on a case-by-case basis.9

The merits of judicial flexibility in determining what constitutes an adequate assurance of payment are clear where each case presents a different set of circumstances concerning the debtor’s financial condition, the debtor’s utility service requirements and the extent of risk of loss to the utility. However, a problem has resulted from the many different interpretations that the courts have rendered in making such determinations. This problem is found in the fact that very little consistency or certainty has developed under the case law as to what criteria should be considered in the determination of adequate assurance of payment. The consequence of this problem is that there is little guidance or precedence as to exactly what general criteria the utility and the debtor should consider in their attempts to arrive at a mutually acceptable ade-

quate assurance of payment. Accordingly, it is not at all surprising to find that the determination of adequate assurance has been one of the most frequently litigated issues in section 366 cases. This issue has become an obstruction to the self-executory nature of section 366, as judicial intervention has become a common aspect of compliance therewith.

The courts' struggle with the interpretation of adequate assurance of payment cannot be ignored. The extent of the struggle is significant when one considers the important role that section 366 plays in the success of the bankruptcy process. It eliminates the imposition of unfair pressure by utilities against bankrupt debtors, preserves the bankrupt estate with continued utility service, and secures the interest and cooperation of the utility creditor in this process with an adequate assurance of payment for future services. The significance of section 366 is even more compelling when viewed from the perspective of the bankrupt debtor. Without the protections of section 366, the debtor would be extremely vulnerable to the loss of utility service and thus, suffer considerable damage. The loss of telephone service to the Chapter 11 business debtor could cripple its reorganization efforts by rendering it virtually incapable of communicating with its associates and clientel, resulting in adverse effects on its attempts to regain competitive viability and to restore its goodwill with the business community. A loss or interruption of electric, gas or water service could cause the operations of the reorganizing manufacturer or service company to come to a standstill. The continuation of these essential services is equally important to the Chapter 7 or 13 individual debtor, whose safety, health and welfare could be jeopardized through a temporary loss of such services. Section 366 protects the bankrupt debtor from the loss of utility service or having to completely cure pre-petition debts with the utility as a condition of continued service. However, in order for the debtor to remain protected by the prohibition against creditor coercion under section 366, the debtor must secure the interest of the utility by providing the utility with some adequate assurance of payment for the future service received in bankruptcy. And so the crucial question remains, "What constitutes adequate assurance of payment for future services?"

This article will focus on the interpretive struggle that the courts have encountered in making determinations of what constitutes adequate assurance of payment under section 366 and how this struggle might be eliminated so as to make compliance with the requirements of adequate assurance of payment less of a problem for the utility and bankrupt debtor. It is the thesis of this article that section 366 determinations of adequate assurance have resulted in interpretive confusion, leaving debtors and creditors with little guidance as to what criteria should be considered in negotiating an adequate assurance of payment. The recommended solution to this uncertainty and confusion as to what criteria would be most useful in section 366 determinations is an increase in judicial deference to state laws and regulations governing security deposit re-
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As will be discussed later, state-based deposit formulas are one of the more common criteria used by utility creditors as evidence of adequate assurance of payment in section 366 cases. The courts, in the majority of these cases, have held that the deposit amounts based on these formulas are reasonable protection for the utility and debtor under section 366.

This recommendation does not suggest or imply that state-based deposit formulas constitute adequate assurance of payment. However, it does suggest that greater judicial deference to such formulas in section 366 determinations would provide the debtor and utility with some definitive guidance as to where they might begin, and hopefully resolve, their independent negotiations of adequate assurance without the need for additional judicial intervention. The state-based deposit formula is a very desirable place for the debtor and utility to begin their independent negotiations of adequate assurance, not only because of the judicial response to the resulting deposit amounts, but also because unlike the other criteria considered in these cases, it is clear, definitive and easy to apply by the parties and is supportive of the principles underlying section 366.

The first part of the article will present a general discussion of section 366 and its applicability, and the aforementioned interpretive issues that have been effectively resolved by the courts. In the second part of the article, there will be an analysis of the various judicial interpretations of the term "adequate assurance of payment" and the various criteria that the courts have considered in determining the reasonableness of the adequate assurance of payment provided. The third part will present an analysis of the case law considering the viability of state laws and regulations governing utility deposit requirements in section 366 determinations of adequate assurance of payment, and an argument favoring greater judicial deference to such state laws as a solution to the interpretative confusion that has amassed under case law in such determinations.

Section 366: A General Overview of Application and Interpretation

As stated above, section 366 was included in the Reform Act to directly address and put an end to the common practice of utilities to force bankrupt debtors to pay outstanding service bills under threats of service termination and the refusal to provide future services. Because this conduct directly discriminated against customers because of their bankruptcy status and any payment made in response to these threats resulted in preferential and unfair treatment of the utility to the assets of the debtor over other creditors, the direct prohibition of such conduct under section 366 is in harmony with the purpose of bankruptcy law. Although section 366 was an obvious champion...
to the previous unfair practices of utilities against bankrupt debtors, it became apparent that the application of section 366 would be somewhat marred by the need for clarification of its scope of coverage and the various terminology used in the provision.

It is under subsection (a) of section 366 that the prohibitive conduct is delineated. The utility is no longer able to alter service, cut-off service or threaten to do so because the debtor has outstanding pre-petition debts, or because the debtor has filed a petition in bankruptcy. This provision reflects the statutory goal of preserving the estate of the debtor in bankruptcy and providing some relief from the pressure of creditors. Subsection (b), the exception to the prohibition of subsection (a), reflects the other goal in bankruptcy which is to equitably preserve the financial interests of creditors that are parties to the bankruptcy. This provision protects the utility from the risk of nonpayment for future services by requiring the debtor to provide the utility with an "adequate assurance of payment" within twenty days after the date of the order of relief. Generally, a demand for adequate assurance of payment is made by the utility. However, the utility may elect not to make the demand and put the burden on the debtor to come forward, within the twenty-day period, and provide the adequate assurance of payment. In the event that the adequate assurance of payment is not provided within the twenty-day period, the utility is then permitted to cut-off or to alter the services being provided to the debtor. Subsection (b) also gives either party the right to request a hearing for modification of the adequate assurance of payment demanded by the creditor or offered by the debtor. For example, the debtor might exercise this right to a hearing for modification of the amount demanded by the utility on the grounds that it is an excessive and unreasonable amount. Similarly, the creditor might seek a modification of an amount offered by the debtor on the grounds that it is insufficient.

One of the first interpretive tasks to come before the courts for resolution...
was the meaning of the term “utility” under section 366. The utility involved in most of the cases arising under section 366 has been the traditional public utility or service company such as an electric, gas, water or telephone company. Although “utility” is not expressly defined under the Code, the legislative history indicates that it was not intended to be limited to public utilities but to include any entity with “some special position with respect to the debtor, . . . that is a monopoly in the area so that the debtor cannot easily obtain comparable service from another utility.” With this expanded view of the term “utility,” entities other than traditional public utilities have been found to come within the scope of the utility under section 366.

In finding that a condominium homeowner’s association was a utility under section 366, the court in In re Hobbs focused on the monopolistic nature in which the services were being provided by the condominium and the difficulty the debtor would have in obtaining comparable services elsewhere. The service the condominium was threatening to terminate if the bankrupt debtor did not pay its outstanding fees included electrical services, which the condominium purchased from the local electric company and then sold to its member-owners. Because the condominium was the direct supplier of the electrical services to the debtor, the court held that “for all practical purposes . . . [it was a] utility against whose monopolistic practices the debtor may seek protection.” Similarly, the court in In re Good Time Charley’s Ltd. focused on the fact that the creditor in that case functioned like a monopoly in its relationship to the debtor, and further noted that the use of the term “utility” rather than “public utility” in section 366 indicated that entities other than public utilities could be considered as utilities under the section. In that case, the court held that a shopping mall was a utility for purposes of section 366 because of its “special position with respect to the debtor,” focusing on the shopping mall’s control of the electricity provided to the bankrupt restaurant-debtor and the fact that the debtor would incur a prohibitive expense if it were required to receive the electric services directly from the electric company.

In re Hobbs and In re Good Time Charley’s Ltd. provide the courts and the parties to bankruptcy with a very clear interpretation of what the term “utility” means and includes under section 366. As noted in In re Good Time Charley’s, “utility” should not be interpreted to apply only to traditional public service utilities by virtue of the fact that Congress did not expressly address, and thus, limit the provision to the “public utility.” Moreover, the courts in In re Good Time Charley’s and In re Hobbs based their interpretations of utili-

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13Id. at 489.
15Id. at 227.
16Id.
ty on the language in the legislative history of section 366, which indicates that Congress was interested in protecting bankrupt debtors from discriminatory conduct by creditors that had “some special position with respect to the debtor, . . . that is a monopoly in the area so that the debtor cannot easily obtain comparable service from another utility.” (emphasis added)\(^2\)

This focus on the legislative history was more recently noted in *In re Gehrke*,\(^2\)\(^2\) where the court concluded that an electricity co-op association was a “utility” within the meaning of section 366 and its rights and claims as a creditor to the debtor would be governed by section 366. The facts of the case revealed that the electricity co-op had been designated by the state regulatory commission to “exclusively” serve the areas in which the debtor’s property was located. The court noted that if the debtor were to obtain service from another supplier, it would have to obtain the permission of the commission, and the other supplier would probably assess the debtor for the cost of running a new line to the property for service connection.\(^2\)\(^3\) The court concluded from these facts that the co-op had “at least, a practical monopoly on electricity service in the subject area such that the debtor [could] not easily obtain comparable service from another electricity supplier.”\(^2\)\(^4\) Accordingly, the “utility” must function like a monopoly in terms of the service it provides to the debtor.\(^2\)\(^5\) The facts must reveal that the service provided can only be obtained by the debtor from the utility-creditor or that the service would be extremely difficult to obtain from another supplier without prohibitive costs to the debtor, thus, making comparable services unobtainable.\(^2\)\(^6\)

The courts have also addressed another significant issue concerning the scope of coverage of section 366. This issue focused on the prohibitive language of subsection (a), which forbids the utility from cutting off, altering or refusing service to the debtor “solely” on the basis of pre-petition indebtedness.\(^2\)\(^7\) From the cases that have directly addressed this issue, a clear statement of the extent of the prohibition has ensued. In its analysis of the prohibition of subsection (a), the court in *In re Broadnax*\(^2\)\(^8\) stated that:

The general rule as stated in section 366 (a) is that a utility may not refuse

\(^{22}\)57 Bankr. 97 (Bankr. Or. 1985).
\(^{23}\)Id. at 98.
\(^{24}\)Id.
\(^{25}\)Id.
\(^{26}\)Id.
\(^{27}\)It should be noted that this issue arose under section 366 as originally enacted, where the language in subsection (a) only prohibited discriminatory conduct by the utility solely on the basis of the debtor’s pre-petition indebtedness. The amendment to subsection (a), which added a prohibition forbidding any discrimination by the utility against the debtor based solely on the commencement of an action in bankruptcy, appears to completely resolve all of the interpretive questions that surfaced concerning the extent of the prohibition under subsection (a). This will be considered in the following discussion.
service to a debtor solely on the basis of an unpaid pre-petition debt. The insertion of the word “solely” into the statutory language of subsection (a) implies that there may be other grounds for the utility to refuse to furnish service.29

The Broadnax court also cited Hennen v. Dayton Power and Light Company30 to support its understanding of the provision. The Hennen court held that “a utility has the discretion to refuse service to any debtor for any reason which would validly constitute a ground for refusal if that debtor were not in bankruptcy with the single exception of nonpayment for past services.”31

The “other grounds” upon which service discrimination, alteration or discontinuance have been based include public safety and creditworthiness. In Broadnax and in a companion case, In re Webb,32 the court had to determine whether a gas company’s refusal to restore gas service to the debtor’s home unless the debtor made restitution for “stolen gas” was conduct falling within the scope of the subsection (a) prohibition. The court held that evidence of the debtor’s tampering with gas company equipment and unauthorized use of gas were valid grounds for refusing to restore gas service or conditioning the restoration of gas service on the payment of stolen gas, and that the prohibitions and duties required of the utilities under section 366 did not apply.33 In Hennen, the debtor petitioned the court to enjoin the utility from demanding that it pay a security deposit under section 366 (b) on the grounds that the deposit requirement discriminated against the debtor because of its petition in bankruptcy. In holding that the security deposit was not prohibited under section 366, the court stated that subsection (a) only prevents the utility from discriminating against a debtor because of a pre-petition delinquency.34 The security demanded by the utility was one that it required from all of its customers who filed petitions in bankruptcy, whether they were current or delinquent in the payment of their utility service bills.35 Thus, the alleged discriminatory conduct was not based on pre-petition debts, but on the debtor’s creditworthiness.36

As with the judicial interpretations of “utility” under section 366, the foregoing interpretations of the prohibitive language of subsection (a) can be described as being relatively clear and consistent, making compliance with sec-

29 Id. at 911.
31 Id. at 724.
33 Broadnax, 37 Bankr. at 911; Webb, 38 Bankr. at 544-545.
34 Hennen, 17 Bankr. at 723.
35 Id. at 724.
36 The internal procedures of the electric utility in Hennen required that all utility customers who filed petitions in bankruptcy apply for new service with the utility for “internal accounting”; the effect of this reapplication process put the burden on the applicant to reestablish credit and created a presumption that one who files for a bankruptcy petition is a “poor credit risk.” Hennen, 17 Bankr. at 723.
tion 366 easier for the utility and the bankrupt debtor. As a result of these decisions, one knows that a utility may terminate, alter or refuse service to a debtor on grounds other than the debtor's pre-petition indebtedness. The only possible litigious issue that might arise in cases like these is one of fact, that being whether the "other grounds" for such discriminatory conduct exist.

In addition to the existing case law interpreting the prohibition of subsection (a), the amendment to section 366 under the Bankruptcy Amendments Act of 1984 may resolve any lingering uncertainties about the reach of the subsection (a) prohibition. As noted earlier, subsection (a) as amended also forbids the utility from terminating, altering or refusing services to the debtor or discriminating against the debtor solely on the basis of the commencement of a case in bankruptcy. While there is no case law currently addressing the impact of this amendment on the prohibition of subsection (a), it is clear that the utility may not discriminate against the debtor solely because of pre-petition debts or because the debtor has filed a petition in bankruptcy. Nevertheless, any reason for service termination other than the debtor's pre-petition indebtedness or the fact that the debtor has filed a petition in bankruptcy would appear to be conduct falling outside of the prohibition of subsection (a) and outside of the scope of section 366. With respect to the meaning of the prohibition of subsection (a), we not only see the courts rendering interpretations that are both clear and consistent, but we also see Congress responding with a subsequent amendment to further clarify the scope of section 366 (a) in terms of the conduct it seeks to regulate.

The amendment to subsection (a) should also have an impact on another interpretive question that arose under section 366. This issue was whether a utility could demand an adequate assurance of payment from a bankrupt debtor who had no pre-petition indebtedness with the utility. Unlike the cases interpreting the meaning of the term "utility" and the extent of the prohibition under subsection (a), there was a split in opinion between the courts addressing this issue. This issue was first considered by the Bankruptcy Court for the Western District of Pennsylvania in In re Coury. In this case the court was asked to determine whether an electric company could demand security deposits from its customers who had filed petitions in bankruptcy, but who had no delinquency in their payments to the utility prior to the filing. The court held that:

Section 366 (b) can only be read in conjunction with section 366 (a). Section 366 (a) states that a utility can only discriminate against a debtor who has defaulted prior to the filing pursuant to section 366 (b); that is, by

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37 For a similar discussion of the Webb, Broadnax and Hennen cases, see Webster, supra note 11 at 19.
39 See supra text accompanying notes 27-31.
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The utility cannot read section 366 (b) as giving rights to security if there has been no default.

The Bankruptcy Court and the District Court for the Eastern District of Pennsylvania followed the In re Coury interpretation of section 366 in similar cases in which the utility attempted to demand security deposits from bankrupt customers who had no pre-petition debts.

However, the court in In re Santa Clara Circuits West, Inc. took a position contrary to the Pennsylvania courts by reading subsection (b) as granting the utility a right to demand adequate assurance of payment from the bankrupt debtor independent of the existence or non-existence of the pre-petition indebtedness of the debtor. The court held that:

While it is true that Section 366 (a) prohibits a utility from altering service to, refusing service to, discontinuing service to, or discriminating against the trustee or the debtor solely because a debt for pre-order-for-relief service was not paid when due, Section 366 (a) is expressly made subject to Section 366 (b) . . . . Section 366 (b) is effective without regard to the pre-order-for-relief status of the debtor's account.

The problem with this interpretation of subsections (a) and (b) is that it gives subsection (b) prominence over the rule of conduct being regulated under section 366, and thus, renders the prohibitive language of subsection (a) null and void. If one is to consider the literal construction of section 366, subsection (b) serves as an exception to the prohibition stated in subsection (a), which is how the court in In re Coury interpreted the provision.

Again, it is important to be mindful of the fact that these cases were decided under the original version of section 366, which prohibited discriminatory conduct based solely on the debtor's pre-petition indebtedness. The amendment to subsection (a) expands the prohibition to also forbid discrimination by the utility against the debtor solely based on the debtor's filing of a petition in bankruptcy. The question as to whether a utility may demand an adequate assurance of payment from a bankrupt customer who does not have any pre-petition indebtedness is now resolved to allow the utility an adequate assurance of payment.


Id. at 683, 684.

See Begley, 41 Bankr. at 406.

In its rejection of the interpretation of section 366 (a) and (b) of Coury, the Circuits West court states that "[Coury] inverts section 366 (a) and 366 (b). Section 366 (a) is not a limitation on section 366 (b). Instead, section 366 (b) is an exception to the prohibitions of section 366 (a)." (emphasis added) Circuits West, 27 Bankr. at 684. This statement reveals the court's misreading of section 366 (a) and the interpretation in Coury, which correctly read subsection (b) as an exception to the prohibition of subsection (a). See Begley, 41 Bankr. at 406; Webster, supra note 11 at 21.
assurance security irrespective of the debtor’s pre-petition indebtedness with
the utility. In re Smith Richardson and Conroy, Inc.,47 is the only case that has
been decided under the amended version of subsection (a) addressing this ques-
tion. In this case, the debtor did not request a court hearing for the modifica-
tion of a deposit demanded by the utility until well after the twenty-day period
had lapsed. It was the debtor’s contention that because it was not in default in
its payments to the utility, “it should not be required to give any adequate
assurance other than that to prepay its utility bill.”48 The court rejected this
argument and held that section 366 “recognizes that a utility may discriminate
against a debtor solely on the basis of the commencement of the case by requir-
ing adequate assurance of future payment by a deposit or other security.”49
The court cited a pre-section 366 case, In re Security Investment Properties,
Inc.,50 as a catalyst for the newly amended section 366. As in Smith Richar-
don, the debtor in Security Investment Properties, Inc. did not have any pre-
petition debts with the utility. However, the court permitted the utility to re-
quest a security for future service noting that: “[w]hile a public utility has a du-
ty to serve, neither its history of past service nor its franchise to serve in the
future may fix upon it a duty to provide unsecured future service to a Chapter
11 debtor.”51 The Smith Richardson court concluded its opinion by declining to
follow the Pennsylvania cases as being inconsistent with the amended provi-
sions of section 366.52

From this initial overview of selected case law that has developed under
section 366, several observations about the provision can be made. Section 366
as originally enacted was clear in its overall purpose to eliminate coercion by
utilities against bankrupt debtors. However, the language of section 366 was
not as clear, leaving several gaps for judicial and ultimate legislative resolution.
Fortunately, judicial interpretation of the issues discussed above was, for the
most part, sound and consistent. The first example being the interpretation of
the term “utility.” While it was not defined under the Code, the legislative his-
tory offered sufficient guidance for the courts to interpret the term with appro-
priate flexibility to include both traditional public utilities and other entities
that were operated like traditional utilities to the extent that they were monop-
olistic in their relationship with the debtor. In this instance, the lack of a spe-
cific or limited definition of utility under the Code proved not to be an obstacle
to the effectiveness of section 366, as the courts are able to render clear and
consistent interpretations of the meaning of the term under section 366.

While the resolution of the two other interpretive questions evolving from

4750 Bankr. 5 (Bankr S.D. Fla 1985).
48Id. at 6.
49Id.
50559 F.2d 1321 (5th Cir. 1977).
51Id. at 1326.
52Smith Richardson, 50 Bankr. at 6.
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the language of section 366 begins with the courts, the ultimate resolution and clarification can be found with the legislative amendment to section 366 under the Bankruptcy Amendments Act of 1984. The courts were asked to determine 1) whether section 366 was applicable in cases where the utility sought to terminate, alter or refuse services to the debtor on grounds other than the debtor's pre-petition indebtedness; and 2) whether the utility could demand an adequate assurance of payment in cases where there was no pre-petition indebtedness. In responding to the first of these issues, the interpretations in Broadnax, Webb and Hennen are consistent in finding that a utility's discrimination against a debtor for reasons other than pre-petition indebtedness did not fall within the prohibition of section 366. However, the interpretations of the courts with respect to the second issue differ. The Pennsylvania courts held that the right of the utility to demand an adequate assurance of payment for future services depended on the existence of the debtors' pre-petition indebtedness; whereas, the court in Circuits West interpreted the right to an adequate assurance to be independent of any pre-petition indebtedness and to be available to the utility whenever the debtor filed a petition in bankruptcy.

The courts that have interpreted 1) the prohibition of subsection (a) to be limited to discriminatory conduct based solely on pre-petition indebtedness; and 2) the utility's right to demand an adequate assurance to also be dependent on the existence of pre-petition indebtedness, can be credited with having rendered structurally sound readings of the language in section 366. However, they do not capture the spirit of bankruptcy law and section 366 which is to protect the debtor who turns to bankruptcy for relief from the pressures of its creditor, while simultaneously preserving the interest of the creditor during the bankruptcy process. By basing the prohibition against discriminatory conduct and the creditor's right to adequate assurance on the existence of some pre-petition indebtedness of the debtor, the existence of the pre-petition indebtedness becomes a focal point for the courts interpreting the application of section 366, instead of the more critical fact that the debtor has sought relief in bankruptcy. Accordingly, it is through the amendment of section 366, extending the prohibition to specifically forbid discrimination based on the filing of a petition of bankruptcy, that these questions are completely resolved under section 366, which can effectively resound the purposes of bankruptcy law.

Thus, we see successful judicial and legislative interpretation and clarification of the language of section 366 with respect to these three issues. However, the question as to what constitutes an adequate assurance of payment under section 366 remains unclear. As mentioned above, "adequate assurance of payment" is not defined under the Code; this was not a legislative oversight, but was purposefully done so that the courts would be able to exercise "reasonable discretion" in determining whether an adequate assurance of payment had been satisfied on a case-by-case basis. The problem that has resulted under this authorization of interpretive flexibility is a lack of con-
sistency or certainty as to exactly what criteria the courts find most reliable and significant in their determinations of what constitutes an adequate assurance of payment. It is also this very question that is most frequently litigated under section 366 cases. In the following analysis of the case law focusing on this issue, the interpretive struggle in assessing what constitutes an adequate assurance of payment becomes apparent. Yet, within the struggle there is a solution to the confusion that has resulted under case law.

**WHAT CONSTITUTES ADEQUATE ASSURANCE OF PAYMENT?: CASE LAW ANALYSIS**

Before beginning the analysis of the "adequate assurance" case law, it is necessary to consider why the determination of adequate assurance of payment is so important to the ultimate success of section 366. Firstly, of the several interpretive issues addressed by the courts under section 366, the determination of what constitutes adequate assurance of payment is one that arises most frequently. This is not at all extraordinary in light of the underlying conflict that frequently results in attempts to provide for adequate assurance of payment under section 366. For example, it is clearly in the debtor's best interest to move forward with some provision of adequate assurance of payment because it will guarantee his or her continued receipt of utility service during the bankruptcy process. However, there is a great likelihood that the utility will respond to the security offered by the debtor as being insufficient to adequately protect it from the risk of the debtor's nonpayment of future services. Conversely, there is an equal possibility that the bankrupt debtor would find the security demanded by the utility-creditor to be excessive and onerous.

The unsuccessful attempts by the parties of interest to negotiate a sufficient security for the utility become obstructions to the bankruptcy process under section 366, requiring judicial intervention for resolution. If, however, the criteria for determining adequate assurance of payment were clearer or more definitive, debtors and utilities would have better and similar understandings of what they must do to comply with section 366 and where they might begin in their negotiations of adequate assurance. This would probably result in less confusion and litigation between the parties as to what must be considered in determining an adequate assurance of payment and would make section 366 an economic, efficient and self-executing remedy under bankruptcy.

Thus far, however, the cases that have focused on this issue vary in terms of the criteria that have been considered by the courts in determining what constitutes an adequate assurance and the way in which the courts have applied these criteria. A certain amount of variety is understandable when one considers the fact that there will be some unique factors and characteristics in each case. Nevertheless, this should not preclude the identification of similar characteristics between the bankrupt debtors and utilities in section 366 cases that may permit some uniformity or consistency in the assessment of the ade
quate assurance of payment. In determining whether an adequate assurance has been provided, a variety of criteria have been considered in the courts' determination such as: the administrative expense priority allowed under section 503(b) of the Code; the specific financial history of the debtor and debtor's relationship with the utility; the utility's post-petition remedies under other bankruptcy provisions; and state and local government laws and regulations governing utility service deposit requirements.

The administrative expense priority has been used as a criterion in determining "adequate assurance" because of a reference to it found in the House Report of the Reform Act, which provides that "if an estate is sufficiently liquid, the guarantee of an administrative expense priority may constitute adequate assurance of payment for future services."53 In brief, the administrative expense is one that is incurred by the trustee or debtor during the course of a bankruptcy proceeding (i.e., in his or her administration or liquidation of the bankrupt estate). Generally, these expenses include estate preservation costs (i.e., storage and repair expenses); taxes incurred by the estate; compensation of court officers who provide services to the trustee (i.e., accountants, attorneys, appraisers, etc.); and expenses incurred by creditors performing a service that benefits the estate or other creditors (i.e., cost for filing involuntary petition against the debtor); and compensation of the estate custodian.54 The administrative expense priority allows the debtor or trustee to pay these expenses as they are incurred during the administration or liquidation of the estate rather than being postponed until the closing of the estate, and it is a claim that takes precedence over the claims of general creditors.

The courts are not in agreement as to whether the administrative expense priority alone may constitute adequate assurance of payment; whether it is one of several criteria that may constitute adequate assurance; or whether it may not be considered as a criterion of adequate assurance in any section 366 determination. In response to a debtor's petition for a determination as to what constitutes adequate assurance, the court in In re Stagecoach Enterprises, Inc.55 rejected the administrative expense priority as appropriate relief for an adequate assurance of payment. The court noted that although there is a reference to the administrative expense priority in the House Report, the Senate Report does not make any reference to the administrative expense priority as being sufficient to constitute an adequate assurance of payment.56 It also states that by allowing the administrative expense priority as a claim for the utility, the rights of general creditors would be "unwarrantedly" prejudiced, and that if

52Section 503(b) lists the kinds of expenses that the court may allow as administrative expense claims. 11 U.S.C. § 503(b) (1982).
54Id. at 734.

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the debtor is continually receiving the utility service, it should pay the bill for such services on a current basis and the adequate assurance of payment should be made in a traditional form of a cash deposit, a payment bond, or some similar device. The court in *In re Woodland Corp.* rejected the utility's contention that the administrative expense priority is "absolutely guaranteed" under section 366. The utility in this case sought the administrative expense priority in addition to a $3,000.00 security deposit, which the parties initially agreed constituted an adequate assurance of payment. The court interpreted section 366 and the legislative history as only giving the debtor the option to guarantee an administrative expense priority to the utility in place of a cash deposit. It also stated that the administrative expense priority would not be allowed because there had been no offer or discussion of the administrative expense priority during the negotiation of adequate assurance between the parties. The court held that if the post-petition supplier's performance is not induced by the debtor with an offer of administrative expense priority, the supplier cannot expect the court to grant it retroactively. According to the court, the utility could have cut-off service to the debtor when the adequate assurance became insufficient and the administrative expense priority would not be available to the utility because it was not negotiated as a part of the adequate assurance of payment between the parties.

Other courts considering the administrative expense priority as a relevant factor in determining adequate assurance of payment have interpreted the language in subsection (b) and the House Report as providing that while adequate assurance of payment does not require an absolute guarantee of payment, it does require some protection for the utility against unreasonable risk of loss of nonpayment, and the possibility of an administrative expense priority may be considered in the court's determination along with other factors. In each of these cases, one finds some variation of the other factors that the courts consider in determining what constitutes adequate assurance. For example, in *In re Keydata Corp.*, the court considered the cash deposit demanded by the utility and the possibility of the utility being entitled to a section 507(a)(1) administrative expense priority in the estate liquidation to be adequate assurance of payment. In its consideration of the administrative ex-

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57 *Id.*
59 *Id.* at 625.
60 *Id.*
61 *Id.*
62 *Id.*

64 12 Bankr. 156 (Bankr. 1st Cir. 1981).
65 *Id.* at 158. Under 11 U.S.C. sec. 507(a)(1) (1982), the administrative expense priority of section 503 is given first priority in the distribution of the estate assets above all other unsecured claims upon the estate liquidation.
pense priority as a criterion of adequate assurance, the court noted that in order for the utility to be entitled to administrative expense priority, the circumstances of the case must show that the service provided is "an actual and necessary expense" of preserving the estate. Similarly, the court in *Circuits West* considered the cash deposit demanded by the utility, in conjunction with the administrative expense priority. However, it added that the court may also consider factors such as the debtor's account history with the utility, the current and future financial condition of the debtor, and the risk of loss to the utility. In *In re Marion Steel* the court considered the administrative expense priority as an adequate assurance of payment, in addition to a cash deposit requested by the utility, the debtor's post-petition financing of operating expenses, and the fact that the utility would be given a prompt hearing by the court to terminate service to the debtor if the debtor defaulted on any post-petition bills for service.

The court in *In re George C. Frye Co.* went so far as to rely on the administrative expense priority as being sufficient to constitute adequate assurance of payment. In that case, the court held "that an administrative expense priority coupled with [evidence of] the debtor's ability to pay current bills," the value of his unsecured assets and a procedure for monitoring the payment of the bills by the debtor to the utility within ten days after the receipt of service, provided the utility with adequate assurance. This is the only case in which a cash deposit was not deemed necessary in the provision of adequate assurance and the administrative expense priority alone was sufficient.

The consideration of the administrative expense priority has not been widely applied by the courts in determining what constitutes an adequate assurance of payment, and thus, does not prove to be a very reliable guideline for the utility and the debtor in negotiating an adequate assurance. There is also the question as to whether the administrative expense priority was intended to be considered as a criterion in adequate assurance determinations. As noted

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66Keydata, 12 Bankr. at 158.
67Circuits West, 27 Bankr. at 685.
6835 Bankr. 188.
69Marion Steel should be compared with *Woodland* in terms of the remedies available to the utility in conjunction with the adequate assurance of payment. The adequate assurance of payment in *Marion Steel* was found in the administrative expense priority, the cash deposit and the utility's right to terminate service in the event of the debtor's post-petition default, which the court held could only be achieved through a hearing. However, in *Woodland* the adequate assurance was limited to the cash deposit and, according to the court, the utility could have unilaterally terminated services to the debtor once this security became insufficient to cover the debtor's liabilities. The additional security provided under the administrative expense priority may explain the differences in the post-petition service termination provisions allowed by the courts in *Marion Steel* and *Woodland*.
71See also *Utica Floor Maintenance*, 25 Bankr. at 1018, citing and agreeing with *George C. Frye Co.* on the point that if the court is able to determine that the debtor has a "substantially liquid estate" no additional security is necessary under section 366(b) to achieve an adequate assurance of payment.
earlier, the court in *Stagecoach Enterprises* questioned the appropriateness of the administrative expense priority as an adequate assurance of payment, indicating that while there is a reference to it as constituting an adequate assurance in the House Report, it was not similarly mentioned as a criterion for adequate assurance in the Senate Report and the allowance of the administrative expense priority would prejudice the rights of general creditors. Moreover, Collier states that: "The legislative history is unclear on the question of whether a simple administrative priority will constitute adequate security. Since an administrative priority will be available to the utility as a matter of course, it is suggested that something more should be required." Another problem that has been identified with the administrative expense priority is found in the House Report, which states that the administrative expense priority may be applied "if the estate is sufficiently liquid." Unfortunately, there is no clear guideline as to what is meant by "sufficiently liquid." It is also important to consider the fact that the administrative expense priority is usually considered in conjunction with other "relevant factors" in determining an adequate assurance. And it happens that there are a myriad of other factors considered by the courts in conjunction with the administrative expense priority, which vary from case-to-case and are not necessarily applied with any systematic approach.

Because the "other relevant factors" being considered by the courts in the determination of adequate assurance of payment are numerous and vary from case-to-case, the problem of uncertainty as to exactly what will be relevant in satisfying the adequate assurance in any given case becomes significant. One of the best examples of variety in terms of what the courts may consider in their determinations is found in *Circuits West*, where the court provides a list of recommended criteria:

In determining adequate assurance, the court may consider the pre-petition security required of the debtor by the utility, the debtor's payment history, the debtor's present and future ability to pay its current expenses, the debtor's net worth, the debtor's cash requirements, the probability of payment through distribution under the bankruptcy law, and, . . . the degree by which the risk of nonpayment from the debtor exceeds the risk of nonpayment from the utility's other customers. The criteria actually considered by the court in this case included the administrative expense priority, the payment history of the debtor, the debtor's assets and liabilities, the debtor's monthly expenses and the risk of loss to the utility.

A survey of the several cases that evaluated the reasonableness of deposits

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1. See supra text accompanying notes 55-57.
2. COLLIr. supra note 8, at ¶ 366.03 at 366-3-366.4.
or other security as adequate assurance, demonstrates that the courts do in fact use the criteria suggested in *Circuits West* in addition to other criteria. However, there is no significant consistency or similarity between the courts in terms of how they actually use the various criteria in each case. For example, the following combination of criteria were considered by several courts: a debtor’s past payment record and the outstanding balance of the debtor’s utility service bill; a cash security deposit demanded by a utility as adequate assurance and the payment procedure and schedule for the deposit; a state-based deposit formula which anticipated the utility’s risk of loss in service discontinuance; the administrative expense priority, the outstanding balance of the debtor’s pre-petition indebtedness, the debtor’s reorganization plan, and the debtor’s future earnings potential; the administrative expense priority, the debtor’s financial condition and the post-petition remedy of setoff under section 553 of the Code. Not only is there a problem with the lack of consistency between the courts in what they are considering in their determinations of adequate assurance, there is also a question as to how much weight is to be given to each factor and why one factor may be considered more significant in a court’s decision than others (i.e., how much more or less weight is to be given to a cash security deposit against a low debtor net worth value, or an administrative expense priority against an irregular utility bill payment history). Moreover, after selecting criteria to be considered, there remains the task of defining certain variables in the criteria that may be necessary for application. For example, what is a reasonable or appropriate formula for determining a sufficient and reasonable cash deposit or for measuring the risk of nonpayment of future services to the utility?

A certain amount of uncertainty as to what should be considered in any determination of adequate assurance is to be expected because of the unique factors in each case. However, there is one criterion that has been frequently offered as evidencing adequate assurance of payment, and that is state or local law regulating utility company deposit requirements. The relevancy of the various state or local laws has been an issue for review in the majority of the section 366 cases that have requested a judicial determination of what con-

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78The payment procedure that was considered by the court in *In re Robmac, Inc.*, 8 Bankr. 1, 3 (Bankr. N.D. Ga. 1979), to be a significant criterion in its determination of adequate assurance was described as follows:

    Any procedure which will regularly and cumulatively pay direct to the utility sums in excess of current service charges to build up the desired security of two months’ average billings within a reasonable period of a few months will provide adequate assurance to the utility.

    Any procedure which will regularly and cumulatively build a protected escrow or trust fund held by the debtor sufficient to assure payments to the utility in cash when bills become due and also build up the two month security will provide the adequate assurance.

    *Id.* at 4.

79See *In re Deiter*, 33 Bankr. 547 (Bankr. E.D. Wis. 1983).


81See Utica Floor Maintenance, 31 Bankr. at 511.
stitutes adequate assurance of payment. In most of these cases, the issue arises because the utility has demanded a security deposit from the debtor that is based on a security deposit formula provided by state or local regulations governing the utility's right to obtain deposits from its customers (state-based deposit formulas). Reliance on the state-based deposit formulas to determine adequate assurance for the utility is understandable in light of the fact that they are generally based on the maximum anticipated loss that the utility will suffer in the disconnection of services to a customer that has become delinquent in the payment of his or her utility service bills. While the purpose of these provisions reflect a concern for the interest of both the utility and the customer, in limiting the amount of deposit that a utility can demand of the customer and in securing the utility from loss in the event of the customer's nonpayment of utility service bills, the courts' reception of these state-based security deposit formulas as evidence of adequate assurance has been tepid at the most.

In considering the state and local deposit provisions, the courts have similarly defined the weight that will be given to such evidence in their determination of adequate assurance. The majority of the courts state that while they are not bound by state or local law in determining what constitutes adequate assurance, they will give some deference to these provisions on the premise that they have some evidentiary value. In most of these instances, the courts find the deposit amounts based on the state formula to be a sufficient and reasonable adequate assurance of payment.

However, the reluctance of the courts to give greater deference to these provisions is truly unfortunate. The state and local law governing utility security deposits is the one criterion considered by the courts that presents the utility and the debtor with a definitive example of a reasonable security deposit that is based upon a formula that anticipates the possible risk of loss that a utility may suffer if the debtor becomes unable to meet his or her financial obligations for service payment. The formula also considers the debtor's account and service relationship with the utility by virtue of the fact that the deposit formula is based upon some percentage of the cost of service that the debtor has acquired from the utility. In most of the cases that have considered the question of what constitutes adequate assurance, the courts have said that the adequate assurance of payment under section 366 should anticipate the

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2See, e.g., supra note 63.

3 An example of the kind of state-based security deposit formula considered by the courts in the adequate assurance cases is found in Section 4933.17 the Ohio Revised Code, which allows utility suppliers of gas, natural gas, water or electricity to require a maximum cash deposit "to cover an estimate of the monthly average of the annual consumption by such consumer plus thirty percent." OHIo REV. CODE ANN. § 4933.17 (Baldwin 1978).

4 Stagecoach Enterprises, 1 Bankr. 732, appears to be the only case in which the court has specifically rejected the state provisions as evidence of adequate assurance.

6See generally cases cited in note 63 supra.
risk of loss that the utility might incur in providing post-petition service to the debtor, and that it should also consider the rehabilitation needs of the debtor (i.e., the service requirements of the debtor and the amount or kind of security that the debtor can afford in its rehabilitation).

As indicated above, the state and local provisions generally reflect some of the same concerns of section 366 in their protection of the utility and the customer, and therefore, should be given more deference by the courts as evidence of adequate assurance of payment. It is the premise of this article that greater reliance on state and local provisions governing utility security deposit requirements would give the utility and the debtor more guidance in determining adequate assurance of payment and make the determination one that they could resolve without judicial intervention. The following analysis of the cases that have considered state-based deposit formulas in section 366 determinations will identify what the courts consider to be essential characteristics for an adequate assurance of payment; how the courts have applied the state-based deposit formulas in section 366 determinations; and why state-based deposit formulas are valid evidence of adequate assurance of payment and should be a general criterion for application in such determinations.

WHAT CONSTITUTES ADEQUATE ASSURANCE OF PAYMENT?: STATE-BASED DEPOSIT FORMULAS AS THE GENERAL CRITERIA

The foregoing review of the section 366 cases addressing the issue of what constitutes adequate assurance of payment reveals a vast number of suggested criteria to be considered in making a determination. The problem identified with the varied way in which the courts have made determinations under section 366, is that the parties of interest, the bankrupt debtor and the utility, have been without guidance as to what criteria would be of the greatest value in their efforts to negotiate a reasonable and mutually acceptable security. Consequently, the utility and the debtor have been forced to seek judicial intervention for the ultimate determination of adequate assurance, costing both parties the loss of time and money in such dispute resolution.

While the need for interpretive flexibility under section 366 has been appreciated, interpretive flexibility in no way should be defined as being synonymous with judicial confusion and inconsistency. The solution to this problem is found in a judicially identified and recommended general criterion that could be applied in most, if not all, section 366 cases so that the parties of interest would have a starting point for their negotiation of adequate assurance. In the less extraordinary bankruptcy cases, it is conceivable that the general criterion could result in the parties finding a mutually acceptable adequate assurance of payment. In the extraordinary cases, the general criterion could be supplemented with other useful criteria to find a mutually acceptable security. The end result would mean easier compliance with section 366 for the parties of interest and a decrease in judicial intervention in these matters.
Attempts to isolate any one criterion from among the various cases as being absolutely necessary in determinations of adequate assurance is extremely difficult. This is largely due to the inconsistency among the courts in their application of the various criteria considered in section 366 cases, and in the failure of the courts to specifically evaluate the importance of the individual criterion in their determinations. However, the state-based deposit formula can be identified as one of the most common criteria considered by the courts in such determinations. It is being recommended as the general criteria for application in section 366 cases not only because of this fact, but more importantly because it is a definitive criterion; it is easy to ascertain and apply; and it can be genuinely offered as evidence in support of the principles and objectives of section 366. The following analysis of the “adequate assurance” cases will review the principles that underlie the concept of adequate assurance, assess the various ways that the courts have considered state-based deposit formulas in the determination of adequate assurance, and identify why the state-based deposit provisions are supportive of the principles of section 366.

There are four principles that underlie the concept of adequate assurance of payment under section 366 according to judicial interpretation. They can be described as follows:

1) The provision of adequate assurance of payment under section 366 must not be discriminatory against the debtor or his trustee simply because the debtor has filed a petition in bankruptcy or because the debtor has pre-petition debts with the utility.

2) The determination of adequate assurance of payment under section 366 shall be left to the reasonable discretion of the courts.

3) The provisions of adequate assurance of payment under section 366 must protect the utility against the risk of loss of nonpayment for future services.

4) The provision of adequate assurance of payment under section 366 must not impose a financial burden upon the debtor so as to thwart or deter the debtor's rehabilitation, and thereby, be an unreasonable demand upon the debtor's resources.

The following case analysis will demonstrate how these principles are applied by the various courts that have made adequate assurance determinations, with particular focus on the consideration of state-based deposit formulas in each case.

The adequate assurance cases that gave the least deference to the state-based deposit formulas are *In re Cunha* and *In re Stagecoach Enterprises Inc.* These two cases were the first section 366 cases litigated. Consequently,
the courts' determinations of adequate assurance were complicated by the fact that these courts had the task of rendering the very first impressions and interpretations of section 366 and delineating the principles embodied thereunder. Because of the newness of the section 366 issue to the courts and the responsibility of the courts to give interpretive meaning to section 366, the analysis of the criteria considered in these cases is very characteristic of the uncertainty and confusion in section 366 determinations that has been identified by this article.

In Cunha, the Virginia Electric and Power Company (VEPCO) petitioned the court to determine that a cash deposit of $280.00, which it demanded from the bankrupt debtor, constituted an adequate assurance of payment under section 366. This deposit was based on a VEPCO security deposit formula approved by its state regulator, the Virginia State Corporation Commission, which allowed the utility to require a deposit from a customer in an amount that did not exceed the customer's service liability for two month's usage. The two basic principles that the court stated must surface in every utility service case is that "a utility may not discriminate against a debtor, . . . simply because at the time of bankruptcy the debtor had not paid for past service" and that the court is "granted reasonable discretion in determining what constitutes adequate assurance of payment for future services." It also stated that in terms of the criteria it will consider in its determination, it "dislikes criteria, one-two-three, which may tend to impose rigor mortis into case-law and application."

In taking this position, the court recommended that the case be analyzed

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*The complete terms and conditions of the VEPCO deposit provision provide that:
The Company may require the Applicant or Customer to deposit with it initially and from time to time, as a guarantee of payment for electricity used, such amounts of cash as in the Company's judgment will secure it from loss. The maximum amount of any deposit shall not exceed the Customer's estimated liability for two month's usage. Whenever a deposit in excess of forty dollars ($40.00) is required of a residential Customer, said Customer will be permitted to pay it in three consecutive equal monthly installments. The Company shall not be bound to supply electricity until these conditions are fulfilled, and it may discontinue the supply if the appropriate deposit is not paid when required. Cunha, 1 Bankr. at 332.

Like most public utility companies, VEPCO is subject to the rate and rulemaking authority of a state commission, which regulates the conduct between the public utility and its customers. Accordingly, VEPCO is required to submit its proposed rates to the commission for approval, which seeks to balance the earning requirements of the utility with the need to assure that affordable and quality utility service will be available to the public consumer.

In Cunha, Vepco argued that it was entitled to the deposit "in accord with the terms and conditions" on file with the state commission. *Id.* at 331. The last sentence of the VEPCO deposit provision provides that if the deposit is not paid, the utility may terminate service. This "right" to terminate service under the approved provision could possibly conflict with section 366, because section 366 provides the debtor with a twenty-day grace period to provide the security requested as adequate assurance and also gives the debtor the right to seek a hearing to have the amount requested by the utility modified if it is considered to be unreasonable. It should be re-emphasized that this article advocates greater judicial deference to the state-based deposit formula in adequate assurance determinations; it does not advocate a judicial acknowledge-
from numerous perspectives. The court's objection to the identification of specific criteria for its determination of adequate assurance is somewhat reflective of the flexibility that section 366 wants the court to have in exercising "reasonable discretion in its determination." However, the flexibility that is advocated by the court in *Cunha* should not necessarily be equated with "reasonable discretion" and should be recognized as leaving the utility and the debtor with no real precedence as to what criteria may be useful in future attempts to achieve adequate assurance of payment.

The *Cunha* court ultimately found a $150.00 deposit to be paid in three equal installments to be sufficient to protect the utility and not to be discriminatory against the debtor under section 366. The facts that are determinative in the court's conclusion are not specifically identified in the opinion. What is interesting to note is that the installment payment schedule adopted by the court in its determination is the same as the deposit schedule approved by the state regulatory commission. Other than this similarity between the state-approved deposit payment schedule and the one adopted by the court in its determination of adequate assurance, there is no other indication from the opinion as to whether any deference was given to the state-based deposit formula.

Although state provisions like the one discussed in *Cunha* and considered in the other adequate assurance cases are not specifically designed with bankruptcy in mind, they share characteristics similar to the concerns reflected in section 366. As noted above, the state regulator is concerned with having service rates that equitably anticipate the earnings and security requirements of the utility and the customer's need to have quality service at fair and affordable prices. Because the utility generally has a monopoly on such services, the close regulation of its services and rates is absolutely necessary so that they do not become oppressive for the customer. Accordingly, there is a natural scale of balance between the two competing interests under state regulation. Moreover, the state approved security deposit typically reflects the maximum

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9 The perspectives from which the court recommended that the case be analyzed, included the following inquiries: "What is the pre-bankruptcy history of the debtor? What is the nature of the debtor, how much is owned and what was the course of dealing on the part of the utility with the debtor? ... When are the circumstances of the debtor in the post-bankruptcy period?" *Id.*

91 It is important to note that the $280.00 deposit demanded by the utility was based on utility service bills incurred by the debtor after the landlord turned the utility service liability over to the tenants. Prior to the change in utility service liability, the electric service costs to the tenants had been covered by the rental fee. Although this change in utility service liability resulted in a reduction in the tenant's rent, this reduction in rent did not equal the increased liability that the tenant actually incurred by having to pay the utility service bill directly. The debtor argued that a deposit of $75.00 was fair. In the opinion, the court made references to the fact that the debtor had demonstrated his desire to turn his condition around after having lost his job due to his health and had a record of being a respectable and responsible person; these facts may have been significant in the court's determination. Moreover, the court may have found the $150.00 deposit to be a more accurate representation of the debtor's service usage and liability in light of the change in the service billing procedure and rental fees.

risk of loss that the utility would incur if they had to terminate service to a customer pursuant to the state rules. A two-month delay in service termination is common because of the delay billing procedure of the utility, the late service payment notice requirements, and the service termination notice requirements that the utility normally has to satisfy before actual service termination is permitted under state law.

Stagecoach Enterprises Inc. differs from Cunha because the court specifically addressed the relevance or value of the state provisions, stating that it was not bound by either the state rules or state-approved tariffs because of the Supremacy Clause of the Constitution, and that it gave "little weight to the tariff and the rules." In Stagecoach Enterprises, the debtor sought a court determination as to whether the deposit requested by the utility was a reasonable security under section 366. The deposit amount requested by the utility was based on the Florida Public Service Commission rules for gas service and the utility's tariff filed with the Commission, which allowed the utility to "require from any customer or prospective customer a cash deposit intended to guarantee payment of bills, such deposit not to exceed ten dollars ($10.00) or an amount necessary to cover charges for two billing periods, whichever is the greater." The theory behind this deposit formula is that it anticipates the disconnect time that is involved in service termination and the maximum loss that the utility would suffer in the event of such termination. As in most of these cases, no real contention was made by the debtor that the utility had altered, refused or discontinued service or discriminated against the debtor under section 366 (a). What the utility appeared to have been doing was exercising the right to have a security under section 366 (b) and relying on the state regulation and approved deposit formula as evidence of adequate assurance. The court did find the amount arrived at under the Florida deposit rule to be "reasonable" under section 366 (b), and the facts to conclusively demonstrate the need for a deposit in an amount equivalent to that requested by the utility. Exactly what facts the court relied on to reach its conclusion are not that well defined. What appeared to be important in the court's review of the facts was the anticipated loss of payment for services that the utility would bear before being able to terminate service.

Both Stagecoach Enterprises and Cunha are frustrating because of the courts' failure to specifically identify criteria as being significant in the ulti-
mate determination of adequate assurance. Where the court in *Stagecoach Enterprises* was virtually silent on the question of criteria to be considered in its determination; the court in *Cunha* was verbose in terms of the various perspectives that it thought a case should be analyzed, but it did not identify any particular criterion as being significant in its determination. And, the one common criterion faced by both courts, the state-based deposit formula, received little or no recognition from either court as being evidence of adequate assurance. Nevertheless, the cases that followed *Cunha* and *Stagecoach Enterprises* reflect some increased judicial deference to and focus on the relevancy of such provisions and formulas in the determination of adequate assurance of payment.

The state-based deposit formula considered in *Houdashell* is similar to the other formulas in that it allowed the utility to require a maximum deposit equal to two times the highest bill of the customer during the preceding twelve months. The debtor argued that the $322.00 deposit calculated under this formula and required by the Missouri Public Service Company, its gas and electric utility supplier, was both excessive and disproportionate to the risk of loss that might be incurred by the utility in providing continued service. In response to a show cause order requesting the utility to explain why the $322.00 deposit was a more reasonable security than a $150.00 deposit that the court had previously found to be sufficient in the ordinary cases involving utility service, the utility referred to the Missouri Public Service Commission regulations governing the termination of utility service and security deposit requirements to justify its request. Like the other state deposit regulations, this provision essentially regulated the utility service termination procedures in such a manner that a delinquent customer could receive close to two months of utility service before actual termination of service was permitted.98

Although the debtor did not take issue with any of the facts asserted by the utility, it did urge the court to make its determination of the reasonableness of the security deposit independent of the state regulations. The debtor noted that section 366 did not make cash deposits mandatory, and that the court should not look at the debtor’s past payment performance in determining the

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98The defendant averred that, under the regulations of the Missouri Public Service Commission, (a)fter an account is unpaid for 21 days, and thereby become delinquent, the utility may discontinue service, but ‘Service shall not be discontinued for nonpayment of a delinquent account within five (5) days after an account becomes delinquent except where written notice is delivered to a customer in which case discontinuance may be effected not less than forty-eight (48) hours after delivery of notice. . . . (f)if a customer receives a bill for October utility service on November 1, (t)hat bill does not become delinquent until November 21, at which time the utility must wait five additional days to disconnect service if the shut-off notice is delivered. This makes disconnection of service possible on either November 27th (the sixth day following mailed notice) or November 24th (the third day following delivered notice). By this time the customer is indebted to the utility for all of October’s service plus 24 or 27 days’ service received in November, . . . close to two months. For this reason 4 CSR 240-13.030(2)(C) and (4)(A) permit a utility to require a deposit from someone with Mr. Houdashell’s payment record, equal to two times the highest bill of that customer during the preceding twelve months.
reasonableness of the security, but rather at what would adequately protect the utility in the light of the debtor's need to rehabilitate. While the court agreed that the debtor's rehabilitation, utility-creditor protection and the exercise of judicial discretion were "paramount and applicable" to its analysis of the security under section 366, it stated that the determination must be done by considering the past payment record of the debtor, in addition to considering the "admirable good intentions" of the debtor to rehabilitate. The court ultimately determined that the amount mandated by the state regulation was "fully reasonable."

The evidence in this case that appeared to be most significant to the court was the payment history of the debtor, showing very irregular service bill payments and instances of nonpayment. The actual appeal of the state-based deposit as being a fully reasonable estimation of adequate assurance was not specifically addressed. What the state provision does in terms of being similar to and somewhat supportive of the principles underlying section 366, is that it anticipates the risk of loss that a utility might suffer in dealing with the delinquent or financially troubled customer, and measures that risk of loss against the value of the service consumption of the customer and the customer's service history with the utility. While this description is meant to show some commonness between section 366 and the state provisions, there is no attempt in this analysis to ignore the fact that these state provisions are not founded on bankruptcy theory, with specific focus on debtor rehabilitation. Nevertheless, the state-based deposit formula is a reasonable starting point for both parties and the courts in determining what is an adequate assurance of payment.

The security requested by the Georgia Power Company (GPC) in Robmac was similarly based on a formula approved by the Georgia Public Service Commission that allowed a maximum deposit in an amount equal to twice an average monthly bill. The court in this case stated that the "formula produces a deposit and security adequate to protect GPC against a loss, given the fact that GPC must supply its service a month prior to the time at which it renders its bill." However, the court noted that its finding of reasonableness was not determined by the rules of the state but by the discretion of the court. It was

9Id. at 903.

10Id.

11"When the unpaid balance is great, the record of payment warrants the description of irregular, and the material facts in this regard are not denied by the plaintiffs, although granted an opportunity to do so, the court believes that the $322.68 which would be mandated by the state regulations, at least is fully reasonable in this case." Id.

12Robmac, 8 Bankr. at 3.

13Id. at 3-4. The court stated that "the reasonableness of the security deposit is not determined by the promulgated [sic] rules of the Georgia Public Service Commission, whether said procedure has the effect of a legislative act or not. It is Section 366 of the Bankruptcy Code which sets the procedure for determination of reasonableness of the deposit or other security; the Bankruptcy Court shall determine what protection is necessary to provide 'adequate assurance of payment' of future utility charges during the pendency of the Title I, U.S.C. case." Id.

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also mindful of the need to be considerate of the rehabilitation of the debtor and that the security must not adversely affect that rehabilitation.\textsuperscript{104} A three-month installment payment schedule satisfied the court's concern as to whether the security being demanded would be burdensome for the debtor.\textsuperscript{105} What is interesting with respect to the payment schedule adopted by the court is that it is very similar, if not identical, to payment schedules allowed under other state deposit regulations.\textsuperscript{106}

\textit{Houdashell} and \textit{Robmac} are examples of cases where state-based deposits are given some deference by the courts in the determination of adequate assurance. Yet, both courts specifically note that the actual determination of adequate assurance is based on the discretion of the court in any given case. The court in \textit{Hennen v. Dayton Power and Light Company}\textsuperscript{107} also noted in its consideration of Ohio law under section 366 that the determination of adequate assurance is a federal question and that state law has only evidentiary value. As in the other cases, the court held that the state-based deposit requested by the utility was not unreasonable.\textsuperscript{108}

What is unique about the treatment of the state law in \textit{Hennen} is in the court's description of the Ohio law as one which "impliesly defines adequate assurance in its directive that residential service may not be withheld if an account is not delinquent and if the consumer provides a security deposit of 130\% of the 'monthly average of the annual consumption by such consumer.' ORC section 4933.17 (B)."\textsuperscript{109} The utility in this case requested that the debtor provide a $75.00 security deposit, which was derived from the state formula and based on a calculation of the average residential customer usage of elec-

\textsuperscript{104} Id. at 4.
\textsuperscript{105} Id.
\textsuperscript{106} Id.
\textsuperscript{107} An example of a similar deposit payment schedule is found in the state approved deposit provisions considered in \textit{Cunha}. See supra note 88.
\textsuperscript{108} 17 Bankr. at 725.
\textsuperscript{109} Id.
\textsuperscript{107} Id. at 724. Section 4933.17 of the Ohio Revised Code provides that:
No person, firm, or corporation engaged in the business of furnishing gas, natural gas, water, or electricity to consumers shall demand or require a consumer to deposit cash as security for payment of any bills for such commodity to be furnished:
(A) If the proposed consumer is a freeholder who is financially responsible or a person who is able to give a reasonably safe guaranty in an amount sufficient to secure the payment of bills for sixty days' supply;
(B) If the security is not demanded within thirty days of the initiation of service, except that this division does not apply where the account of a customer is in arrears.
In case no such security can be furnished, a deposit not exceeding an amount sufficient to cover an estimate of the monthly average of the annual consumption by such consumer plus thirty percent may be required, upon which deposit interest at the rate of not less than three percent per annum shall be allowed and paid to the consumer, provided it remains on deposit for six consecutive months.
Any person, firm, or corporation convicted of a violation of this section shall forfeit all right to collect or receive any sum from such consumer for gas, natural gas, water, or electricity so furnished. The making of any rule or requirement in conflict with this section, is forbidden, and hereby declared to be unlawful.
trical services. This deposit was routinely demanded by the utility of all residential customers who filed petitions in bankruptcy regardless of their past transactions with the utility, that is, regardless of whether they were current or delinquent in their utility service bill payments. After concluding that the deposit was reasonable, the court opined that a general application of the $75.00 deposit in all future Chapter 13 cases would help make bankruptcy administration more efficient and eliminate the need for judicial intervention in such determinations. A superintendency rule requiring the $75.00 in all Chapter 13 cases was issued by the court which provided that:

Every debtor's plan, as duly confirmed by the court, will contemplate a deduction of $75.00 from each debtor's initial payment(s) to the Trustee to be held in reserve as adequate assurance to the public utility of payment for future service after the utility has filed a proof of claim in a case showing a pre-petition delinquency. Payment for such future utility services from the deposit shall be considered and treated by the Trustee as statutory administrative priority ahead of all payments to other non-priority creditors. Upon consummation of all payments by the Trustee under the Plan as confirmed by the court, the $75.00 deduction(s) withheld shall be disbursed by the Trustee as excess funds.

This action by the court is extremely significant in that the court has essentially recognized section 366 as a self-executing bankruptcy provision that should not require judicial intervention for compliance, except in the extraordinary case, and seeks to enhance this characteristic of section 366 by giving some definite criterion to the parties of interest as to what might constitute adequate assurance of payment, using an amount that is based on a state deposit formula as that criterion.

Hennen is not the only case that shows a sign of judicial recognition of the usefulness of some general criteria as a catalyst in determinations of adequate assurance for the parties of interest. For example, while the court in Circuits West suggested a myriad of possible criteria that should be considered in

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10Hennen, 17 Bankr. at 725.
11Id. at 725-26. In a subsequent case, In re Tabor, 46 Bankr 677, (Bankr. S.D. Ohio 1985), the General Telephone Company of Ohio demanded that a bankrupt debtor pay a deposit of $600.00 as adequate assurance. The trustee responded with a deposit of $1.00. The utility disconnected the debtor's service because it failed to remit the demanded deposit within the twenty-day period. The same court that decided Hennen held that the utility and the trustee ignored its superintendency order for chapter 13 cases and that both were equally in fault. The court ordered the utility to pay $250.00 for its contempt of the court's order and $525.00 for damages that the debtor suffered as a result of the service termination.
12Although this article advocates increased judicial consideration of a general criterion in section 366 cases, as is similarly suggested by the Hennen court, the use of a set deposit amount of $75.00 is not as desirable as the use of the formula per se. The superintendency rule has the effect of resulting in disparate treatment between customers whose average monthly consumption is less than $75.00 and those whose consumption is in excess of $75.00. The use of the formula would be more reflective of the account relationship between the customer and the utility and more reflective of the potential loss that the utility would suffer with a specific bankrupt customer. Moreover, the state-based formula is applied to all utility customers, whether they are solvent or bankrupt, according equal treatment to all utility customers.
a section 366 determination,¹¹³ it also stated that "standards more surely determinable than those [it refers to] may be helpful to debtors and utilities in their negotiations toward avoidance of the cost and delay of the judicial determination."¹¹⁴ The facts in Marion Steel indicate that the debtor and the utility in that case did negotiate a mutually acceptable security deposit that began with a consideration of a state-based deposit formula. However, judicial intervention was necessary to determine under what conditions the utility could terminate service in the event the debtor defaulted on the payment of the agreed upon security deposit.¹¹⁵ In In re Deiter the court looked to the Wisconsin Public Service Commission deposit guidelines to determine the adequate assurance of payment for the Madison Gas and Electric Company.¹¹⁶ The court's deference to the state guidelines was given little explanation other than the court finding that: "The guidelines of the Wisconsin Public Service Commission which suggest that the two highest consecutive monthly bills during the previous 12-month period should provide the basis for a deposit seems to reflect well the anticipated period of delay in accomplishing disconnection. (emphasis added)¹¹⁷ The state-based deposit of $260.00 required by the court was contrary to the deposit amount suggested by the utility of $757.07, which was based on the total utility bill arrearage incurred by the debtor, and the amount suggested by the debtor of $200.00. Most recently, the court in Lloyd v. Champaign Telephone Co.¹¹⁸ held that a security deposit based on the regulations of the Public Utilities Commission of Ohio provided the Champaign Telephone Company with an adequate assurance of payment under section 366. Although, court specifically noted that the “determination of ‘adequate assurance’ is within the province of the bankruptcy court, which is not bound by state regulations or policies promulgated on the basis of state regulations,”¹¹⁹ it also stated that the amount derived from the deposit formula appeared “prima facie to be reasonable.”¹²⁰

The development of the case law on this question of state regulations and their role in section 366 determinations clearly reveals some judicial recognition of the value of state-based deposit formulas in adequate assurance determinations. These provisions have been regarded by the courts as addressing utility risk of loss under section 366 by estimating the utility's risk of loss on

¹¹³See Circuits West, 27 Bankr. at 685.
¹¹⁴Id. at 686.
¹¹⁵Marion Steel Co., 35 Bankr. at 191. The dispute over service termination was whether the utility would be able to unilaterally terminate service to the debtor upon failure to pay the agreed upon deposit, or whether a hearing would be required to determine the utility's right to terminate service. The court held that a unilateral termination was not appropriate and that a speedy hearing before the court would be sufficient to protect the utility's interest.
¹¹⁶Deiter, 33 Bankr. at 548-49.
¹¹⁷Id.
¹¹⁹Id. at 656.
¹²⁰Id.
the basis of the debtor's account history with the utility. In some instances, the state provisions have also been influential in the court's attempts to accommodate the debtor's payment burdens through the adoption of installment payment schedules that are provided for under state regulations. The application of state-based deposit formulas in determining adequate assurance also treats the bankrupt debtor like the solvent customer because the formulas are applicable to all of the utility's customers, which would eliminate possible discrimination by the utility against the bankrupt debtor in its assessment of a reasonable security. A more important revelation from this case law analysis is the courts' growing sensitivity to the need to apply more standard and definite criteria in section 366 determinations in order to enhance independent debtor-utility compliance and to make section 366 a more efficient remedy in the rehabilitation process.

The final issue to be addressed in supporting the application of state-based deposit formulas in section 366 determinations is whether the federal pre-emption doctrine would have any impact on the validity of such determinations. Opponents of a state-based deposit formula might argue that the court is not bound by state law or regulation in bankruptcy cases by virtue of the Supremacy Clause of the Constitution and urge the rejection of such formula in the determination of adequate assurance under section 366. Interestingly, the question of pre-emption has not been a significant or frequent issue in any of the section 366 cases that have considered state or local law.

One of the most extensive discussion of the federal pre-emption doctrine under section 366 is found in Stagecoach Enterprises, in which the court held that it was "not bound by either the [State] tariff or the Rules because of the Supremacy Clause of the United States Constitution, Article VI, Cl. 2" and added that it would give "little weight" to the tariff and the state public service commission rules.121 As noted above, other courts have lightly touched upon

121 Stagecoach Enterprises, 1 Bankr. at 735. The issue of pre-emption of state utility deposit provisions in bankruptcy has also been addressed in In re Fountainebleau Hotel Corp., 508 F.2d 1056 (5th Cir. Ct. 1975); In re Financial, Inc., 594 F.2d 1275 (9th Cir. Ct. 1979). These cases, however, were decided prior to the enactment of section 366. In both cases, the courts were required to determine whether a telephone company could exercise its right under state law to demand security deposits from financially delinquent customers, who had filed petitions in bankruptcy, as a condition for continued service. The courts agreed that the state law was pre-empted by the federal bankruptcy law, stating that the state right to demand a deposit was subordinated once a petition in bankruptcy had been filed and federal bankruptcy law was in effect. They also stated that to rule otherwise would render the Bankruptcy Act of 1898 meaningless and would contravene the purposes and objectives of the Act to the extent that state law preferred the utility creditor over other creditors by allowing the utility to obtain payment of a pre-petition debt during the bankruptcy proceedings.

In Begley v. Philadelphia Electric Co., 760 F.2d 46 (3rd Cir. Ct. 1985), the Third Circuit Court of Appeals held that section 366 did not pre-empt Pennsylvania utility regulations governing termination procedures in a Chapter 7 proceeding where the service termination was sought because of the debtor's non-payment of post-petition bills. The court held that section 366 was not relevant when the utility sought termination based on post-petition arrearages because the restrictions of section 366 apply to those "terminations which issue 'solely on the basis' that a debt incurred prior to the bankruptcy order, was not paid when due." (Emphasis added) Id. at 49. Accordingly, the Pennsylvania utility regulations would not be pre-empted by section 366 if termination is based on the debtor's non-payment of post-petition utility bills.
this question and stated that, like the court in *Stagecoach Enterprises*, they were of the opinion that they were not bound by state law and that state law had only evidentiary value in a court's final determination of what constitutes an adequate assurance of payment. The problem with all of these cases in addressing this question is that there is no discussion of the courts' analysis of the applicability of the pre-emption doctrine to section 366. What the courts' appear to be doing, more or less, is pronouncing and reaffirming their "discretion" under section 366 to determine what constitutes adequate assurance of payment for the utility in any given case. The thesis of this article is not in contravention with this pronouncement, if anything it is in complete agreement with the courts' interpretation of their authority to exercise discretion under section 366. What the thesis does recommend is that the courts give more serious and uniform consideration of state-based security deposits in the exercise of this discretion. This article does not suggest or advocate that the state law become a substitute for court discretion.

The issue of focus in applying the pre-emption doctrine to federal and state laws is to determine to what extent the state law "stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress." In the event that there is an actual conflict between the authority exercised under the federal law and the state law, such that the two provisions cannot stand together or compliance with both is impossible, the state law must fall and will be overridden by the federal law under the Supremacy Clause. Accordingly, in addressing a federal pre-emption question, the court has to determine whether rights or authority granted and exercised under state law is in conflict with governing federal law. Because this article does not recommend or suggest that the utility's rights or authority under state or local law become a substitute for federal law or be exercised in conjunction with section 366, the federal pre-emption doctrine is not an issue of concern. As stated before, the recommendation offered herein is that the courts give greater deference to the state-based deposit formulas in exercising their discretion in determining what constitutes an adequate assurance of payment under section 366; it does not recommend that the utility's rights under state law be recognized under section 366. Thus, increased judicial deference to state-based deposit formulas in section 366 determinations is not an issue that should prompt a federal pre-emption question.

CONCLUSION

The importance of section 366 to the bankruptcy process is great. This becomes particularly apparent when one considers the fact that continued

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See Robmac, 8 Bankr. at 3; Hennen, 17 Bankr. at 725; Utica Floor Maintenance, 25 Bankr. at 1014; Tabor, 46 Bankr. at 679; Marion Steel Co., 35 Bankr. at 199; Circuits West, 27 Bankr. at 685.

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receipt of telephone, electric, gas and water service to the debtor is crucial to the rehabilitation process for both the personal and business debtor, the absence of which would more than likely impede that process drastically and cause damage. Section 366 of the Code protects the debtor’s ability to receive these essential services while in bankruptcy and eliminates financial coercion by the utility against the debtor because of his or her bankruptcy status or pre-petition indebtedness. Section 366 also attempts to balance the debtor’s interest in continued service with the utility-creditor’s interest in payment for such service through the provision of adequate assurance of payment.

It is the premise of this article that the ultimate success of section 366 as a bankruptcy remedy is dependent upon its being a self-executing provision of relief, that is, a provision that can be complied with by the parties of interest through extra-judicial negotiations and without any administrative delay. The factor that will be most determinative of this success will be the parties’ negotiations of adequate assurance of payment; what kind or amount of security will adequately protect the interest of the utility-creditor providing post-petition service and, at the same time, will not be financially burdensome to the distressed debtor.

Unfortunately, the determination of adequate assurance has not been an easy one for the parties of interest or the courts. This problem can largely be attributed to the Congress’ decision to leave the determination of “adequate assurance of payment” to the reasonable discretion of the courts. The main reason for this is understandable and obvious, no one bankruptcy case is the same, debtors and creditors are unique, and their relationships and circumstances will not necessarily be the same. However, it does not necessarily follow that similarity is absent in these cases, and that such similarity should not be considered in the determination of adequate assurance where it may prove helpful.

The obvious similarity in such instances is that our debtor is financially distressed and having difficulty with his or her financial obligations, and the creditor under section 366 is in the vast majority of cases a public service utility company. The utility is invariably subject to state regulations governing the utility’s ability to terminate service to its customers and the rates that it may charge to its customers for service. In the regulation of rates and service termination, we see that the state provisions also define the maximum allowable security that the utility may charge its customers as protection against the risk of loss, should the customer encounter financial difficulty and become delinquent in the payment of his or her obligations with the utility. While it is true that these regulations are not drafted specifically with a bankrupt debtor in mind, they are concerned with the reasonableness of the rates and security deposits charged by a utility to its customer and the probable amount of loss that the utility may incur if the customer becomes financially distressed. The state-based security deposits are arguably a reasonable starting point for the
parties of interest in their negotiations of adequate assurance. Moreover, the use of formulas similar to those allowed under state laws in regulating the traditional public utility may be equally appropriate for application in determining adequate assurance of payment for the non-public utility under section 366 (i.e., a residential condominium association or a shopping mall).

The need for some standard criterion in adequate assurance determinations has been noted by the courts as a possible way of making the process of compliance with section 366 easier and more efficient in terms of bankruptcy administration and cost.\textsuperscript{124} The state-based deposit formula seems to be a logical choice for a standard criterion. It has been offered as evidence of adequate assurance in most of these cases, and interestingly, the amounts arrived at under these provisions have been found by several courts to provide reasonable security to the utility under section 366. The court in \textit{Hennen v. Dayton Power \\& Light Company}, went so far as to include an amount arrived at under such a formula in a superintendency rule that it issued for application in all Chapter 13 cases as an initial security of adequate assurance of payment. Cases like \textit{Hennen} and \textit{Circuits West} reveal a judicial sensitivity to the problem of adequate assurance determinations between the parties of interest and for the courts. These cases see the potential of standard criterion as a solution to the problem by eliminating the uncertainty as to what criteria the parties might consider in their negotiations to find a mutually satisfying security.

Neither of these cases nor this article suggests that such a criterion become a substitute for judicial discretion in adequate assurance determinations when intervention becomes necessary. What is being suggested herein is that increased judicial deference to and note of such formulas as valid evidence of adequate assurance, where appropriate, may be a signal to the parties of interest to begin their negotiations of adequate assurance with the state-based deposit formula, supplementing it with other important criteria when necessary to reach a mutually acceptable security. It is possible that the use of this criterion as a standard beginning may be the answer to the interpretive struggle that has plagued the courts in section 366 determinations and may be significant in the realization of section 366 as a self-executing provision, no longer demanding the time and cost of judicial intervention for resolution.

\textsuperscript{124} See supra text accompanying notes 113-20. The cases express a need for standard criteria in section 366 determinations.