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Electricity: A "Good" under the UCC. Should be a Simple Question - Right?

A question which often arises in the litigation of power supply contracts is whether the transaction is governed by the Uniform Commercial Code ("UCC"). Article 2 of the UCC applies to "transactions in goods." UCC § 2-102. A "good" is defined as "all things . . . which are movable at the time of identification to the contract for sale . . ." UCC § 2-105. For those involved in the generation and transmission of electricity, this may appear to be a fairly straightforward question. Electricity is generated, sold under contract, and transmitted, i.e. moved, to its ultimate destination where it is consumed. It should not matter that electricity cannot be stored or that it is consumed rapidly. Surprisingly, however, the courts are split on whether electricity is a good governed by the UCC. The answer to this question is anything but inconsequential. It can be a decisive factor in litigation.

A recent decision from the U.S. District Court for the Southern District of New York, *Enron Power Marketing, Inc. v. Nevada Power Co.*, 2004 U.S. Dist. LEXIS 20351 (S.D.N.Y. October 12, 2004), was the most recent decision to grapple with the question of whether electricity is "good" under the UCC.

In *Enron Power Marketing*, Enron had sued Nevada Power Company for "Termination Payments" resulting from Nevada Power's breach of the parties transactions under Western Systems Power Pool Agreement (WSPPA). *Id.* at *2. Agreements under the WSPPA are controlled by Utah law.^[1] Both the WSPPA and Utah law are silent as to whether electricity a "good" within the meaning of the UCC. Hence the court's threshold question: "is electricity a good?" If so, the UCC would govern. If not, the common law would govern.^[2] The court determined that electricity was a good under the UCC, reasoning that because other states have held it to be a "good," it was a good in Utah. *Id.* at *5. Accordingly, the court applied the UCC to the contract dispute.

Courts Are Split

The *Enron* court joins several other courts that have found electricity to be a good under the UCC.^[3] The reasoning these courts employ is fairly straightforward—electricity is a "thing movable" and thus falls squarely within the UCC's definition of a "good":

Simply put, electricity in this instance is a thing movable at the time of identification to the contract for sale. That is clearly demonstrated by the fact that the Agreement calls for the shipment of specific quantities of electricity. The electricity is moved through the power lines and the amounts are metered and therefore identifiable. The court will apply the U.C.C.

Puget Sound Energy, Inc. v. Pacific Gas & Electric Co., 271 B.R. 626, 640 (N.D. Cal. 2002). As one court noted in one of the earlier cases on the subject, "[e]lectricity is a commodity which, like other goods, can be manufactured, transported and sold." *Baldwin-Lima-Hamilton Corp. v. Superior Court*, 208 Cal. App. 2d 803, 819 (1962).

Other courts, however, have reached the opposite conclusion. For example, in New York, Kentucky, Maryland, Massachusetts and Michigan, courts have found that electricity is not a good, but instead is a service.^[4] Some of these courts have adopted almost a metaphysical approach to analyzing the issue which ignores the fact that electricity is a moveable, physical product, despite its invisibility to the human eye:

[T]he provision of electricity is a service, not the sale of a product. . . . Electricity is the flow of electrically charged particles along a conductor. The utility does not ‘manufacture’ electrically charged particles, ‘but rather, sets in motion the necessary elements that allow the flow of electricity.’ [Citation omitted.] The consumer pays for electricity by kilowatt hour, that is, the length of time electricity flows through the system. There is no individual product. Instead, the consumer pays for use of the electricity.

Bowen v. Niagra Mohwak Power Corp., 183 A.D.2d 293, 297 (N.Y. App. Div. 1992). This reasoning is dubious as it appears to be more a discussion of the transmission of electricity, rather than the electricity itself. The New York court also appears to be exhibiting fundamental misunderstanding regarding the generation of electricity. The discussion appears to focus on whether the utility is a distributor or a generator, rather than whether electricity is a movable thing. Nonetheless, several courts have followed this reasoning. Other courts have grounded their reasoning in public policy, expressing concern about the implications of subjecting heavily regulated utilities to the UCC’s warranty remedies.^[5] And while many of the cases finding electricity to be a service arise from tort actions (e.g., damages caused by stray electricity, power surges, or contact with power lines), at least one state—New York—considers electricity a service, even in commercial contract litigation.^[6]

Finally, some courts have determined that whether electricity is a good depends on where it is in the distribution chain. If the electricity is metered, as it is when it enters a home, then these courts find it to be a good to which the UCC applies. If, however, the electricity is in high-voltage transmission lines, then these courts find that it is not a “good,” and that the UCC does not apply.^[7] The rationale of these cases centers more on the existence of a transaction as opposed to the characteristics of electricity. For example, in a personal injury case where plaintiffs sought remedies under the UCC’s warranty provisions, the court rejected application of the UCC to high-voltage power:

The high-voltage electricity with which the [plaintiffs] came into contact was not the good [the utility] was intending to sell or the [plaintiffs] were intending to buy. . . . [T]he tragic escape of 7200 volts from the transmission wire, through the ladder, and into the bodies of these men is not a transaction in goods intended to be covered by the Uniform Commercial Code.

Hedges v. Public Service Co. of Indiana, 396 N.E.2d 933, 936 (Ind. Ct. App. 1979).

The split of authority makes it important for parties in power transactions to understand: (1) which state’s law will govern their contract, and (2) what are the implications if the UCC applies or does not apply. This is true even for parties that are transacting under an umbrella agreement, such as the WSPPA. While the *Enron Power Marketing* decision provides support for application of the UCC to the WSPPA, it remains to be seen what Utah state courts or other district courts may decide. Moreover, other power pool agreements incorporate the laws of other states that have not addressed whether electricity is a good under the UCC.^[8] And like the WSPPA, most power pool agreements do not address whether the UCC or the common law will govern a dispute. In such cases, contracting parties would be well-advised to understand the implications of applying the UCC or the common law.

Whether the UCC Applies Can Materially Impact A Parties’ Rights Under the Contract

Whether the UCC governs the parties’ rights and obligations under a contract is an important consideration because, in many states, the common law differs from the UCC. On issues ranging from the formation of a contract to the available remedies and damages for breach, application of the UCC may have a critical impact.

For example, one significant difference between the UCC and the common law, in many states, involves modification of existing contracts. Suppose a seller and buyer agree to a 5-year, 10MW electricity supply contract at \$40/MWh. Suppose further that the buyer and seller later agree to renegotiate the price term to

\$30/MWh, with no other changes to the original agreement. Under the UCC, this modification would be valid even if there is no additional consideration supporting the seller's agreement to lower the price. See UCC § 2-209(1).^[9] If, however, the contract is not governed by the UCC, courts in some states may find that the modification is unenforceable unless additional consideration supports the seller's concession to lower the price.^[10]

Another example of a potentially significant difference between the UCC and common law is the admissibility of parol evidence. In many states, parol evidence is admissible to demonstrate the meaning of a contract *only* after the contract has been found to be ambiguous. Under the UCC, however, the court need not find the contract ambiguous in order for extrinsic evidence of the parties' course of dealing, trade usage, or course of performance to be admitted. See U.C.C. § 2-202(a).^[11]

Know Which Law Applies

Not all the significant differences between the common law and the UCC can be discussed in this space. In some cases the differences may be crucial, and in others they may not be material difference at all. The varying factual and legal permutations in each individual case will decide. The key is knowing in advance whether the UCC will govern a transaction, and understanding the implications of its application, or non-application to the particular transactions. In this way, the parties can make informed decisions regarding their rights and obligations under the contracts, and better assess their risks in litigation. In *Enron Power Marketing*, application of the UCC turned out to be a key component of the court's decision, which relied extensively on the UCC's "adequate assurances" provisions to interpret the WSPPA and address the parties' arguments. Had the court consulted Utah common law, it would have found no guidance, as Utah common law does not recognize the doctrine of adequate assurances.

It is therefore prudent to determine before entering into any power contract which state's law will apply. One consideration to keep in mind, however, is whether the courts will enforce the choice of law provision. In at least some jurisdictions, the choice of law rules requires a nexus or "substantial relationship" between the contract and the state law selected. Parties may also want to consider specifically stipulating that the UCC applies. Of course, in any analysis both buyer and seller must evaluate whether they deem the UCC or common law to be in their best interests.

[1] See WSPP § 24. The latest version of the WSPP is available online at http://www.wspp.org/Documents/WSPP%20Web%20Site/Agreement_Docs/2004_02_01%20Effective/Feb%2004%20Effective%20Amendments%20Non-Redlined.doc.

[2] The WSPP does not speak to whether contracts entered into under its provisions are governed by the UCC or common law.

[3] See, e.g., *In re Pac. Gas And Elec. Co.*, 2004 U.S. Dist. LEXIS 22023 (September 30, 2004) ("Transport of a quantity of electricity is considered a movable 'good' within the meaning of the UCC."); *Puget Sound Energy, Inc. v. Pacific Gas & Electric Co.*, 271 B.R. 626, 638-40 (N.D. Cal. 2002) (electricity is a good under the UCC); *Grant v. Southwestern Electric Power Co.*, 20 S.W.2d 764, 771 (Tex. Ct. App. 2000) rev'd on other grounds in *Southwestern Electric Power Co v. Grant*, 73 S.W.3d 211 (Tex. 2002).

[4] See *Bowen v. Niagara Mohawk Power Corp.*, 183 A.D.2d 293 (N.Y. App. Div. 1992); *G&K Dairy v. Princeton Electric Plant Bd.*, 781 F. Supp. 485 (W.D. Ky. 1991); *Singer Co. v. Baltimore Gas and Electric Co.*, 558 A.2d 419, 470-72 (Md. Ct. Spec. App. 1989); *New Balance Ath. Shoe v. Boston Edison Co.*, 1996 Mass. Super. LEXIS 496 (Mass. Super. 1996); *Williams v. Detroit Edison Co.*, 234 N.W.2d 702, 705-06 (Mich. Ct. App. 1975); *Norcon Power Partners, L.P. v. Niagara Mohawk Power Corp.*, 705 N.E.2d 656 (N.Y. Ct. App. 1998).

[5] See *New Balance Ath. Shoe v. Boston Edison Co.*, 1996 Mass. Super. LEXIS 496 (Mass. Super. 1996).

[6] See *Norcon Power Partners, L.P. v. Niagara Mohawk Power Corp.*, 705 N.E.2d 656 (N.Y. Ct. App. 1998). The *Norcon Power Partners* decision was the last in a string of decisions that started with a federal court decision in *Encogen Four Partners, L.P. v. Niagara Mohawk Power Corp.*, 914 F. Supp. 57 (S.D.N.Y. 1996), where the court held that, under New York law, electricity was not a "good" under the UCC, and that

New York common law did not recognize the right to demand adequate assurances. On appeal, the Second Circuit did not disturb the determination that electricity was not a good, but certified a question to the New York Court of Appeals about whether the doctrine of adequate assurances should apply to contracts that are not governed by the UCC. See *Norcon Power Partners, L.P. v. Niagara Mohawk Power Corp.*, 110 F.3d 6 (2d Cir. 1997). The New York Court of Appeals answered that question in the affirmative. *Norcon Power Partners, L.P. v. Niagara Mohawk Power Corp.*, 705 N.E.2d 656 (N.Y. Ct. App. 1998).

[7] See *Hedges v. Public Service Co. of Indiana*, 396 N.E.2d 933, 936 (Ind. Ct. App. 1979) (noting that electricity is a “good” under the UCC when it has been metered, but finding that electricity escaping from a high-voltage power line is not a transaction in goods subject to the UCC); *Cincinnati Gas & Electric Co. v. Goebel*, 502 N.E.2d 713 (Hamilton County Mun. Ct., 1986) (“We distinguish electricity in its raw state from metered amounts passing through utility-owned conduits and into the homes of consumers. The latter-described form of electricity is ‘goods’ as defined in the Uniform Commercial Code.”); cf. *Schriner v. Pennsylvania Power & Light Co.*, 501 A.2d 1128, 1134 (Pa. Super. 1985) (“In other words, while still in the distribution system, electricity is a service, not a product; electricity only becomes a product, for purposes of strict liability, once it passes through the customer’s meter and into the stream of commerce.”); *Bellotti v. Duquesne Light Co.*, 44 Pa. D. & C.3d 425 (Pa. Ct. Comm. Pleas 1987) (applying same analysis in *Schriner* to determine that metered electricity was a good under the UCC).

[8] The Mid-Continent Area Power Pool, for example, is governed by Minnesota law (see <http://www.mapp.org/assets/pdf/Restated%20Agreement%20Amendments/Restated%20Agreement.pdf> (MAPP Agreement § 11.9)), which has not expressly decided whether electricity is a good under the UCC. Similarly, Arkansas law, which governs the Southwest Power Pool (see http://www.spp.org/Publications/SPP_MshipAgrmt_11012004.pdf (Southwest Power Pool Membership Agreement § 8.1)), has not expressly addressed whether the UCC will govern electricity transactions.

[9] See, e.g., *Sara Lee Corp. v. Quality Mfg., Inc.*, 201 F. Supp.2d 608, 613 (M.D.N.C. 2002) (“Under the UCC, the common law pre-existing duty rule is largely abrogated, requiring no additional consideration for contract modifications.”); *Allapattah Services, Inc. v. Exxon Corp.*, 61 F.Supp.2d 1308, 1316 (S.D. Fla. 1999) (“[C]ontracts controlled by the UCC do not require a modification to be supported by consideration.”); *Ritz-Craft Corp. v. Stanford Management Group*, 800 F.Supp. 1312, 1317 (D. Md. 1992) (“An agreement modifying a contract for the sale of goods within the UCC, needs no consideration to be binding . . .”).

[10] See, e.g., *Watson Electrical Const. Co. v. Summit Companies, LLC*, 587 S.E.2d 87, 94 (N.C. Ct. App. 2003) (“[W]here a contract has been partially performed . . . a modification of its terms is treated as any other contract and must also be supported by consideration.”); *Advance Iron Works, Inc. v. ECD Lincolnshire Theater, L.L.C.*, 791 N.E.2d 631, 634 (Ill. App. Ct. 2003) (“Terms may be modified as long as there is consideration for the modification”); *Coniglio v. White*, 804 A.2d 990, 995 n.5 (Conn. App. Ct. 2002) (“[F]or modifications of a contract to be enforceable, there must be new consideration.”); *Givens v. Mullikin ex rel. Estate of McElwaney*, 75 S.W.3d 383, 406 (Tenn. 2002) (“[M]odification of an existing agreement which imposes new obligations on one of the parties is unenforceable for lack of consideration unless it also imposes a new obligation on the other party.”); *Jole v. Bredbenner*, 768 P.2d 433, 435 (Or. Ct. App. 1989) (“To be binding, a modification of a contract must be supported by consideration.”); *Hathaway v. General Mills, Inc.*, 711 S.W.2d 227, 228 (Tex. 1986) (“A modification must satisfy the elements of a contract: a meeting of the minds supported by consideration.”).

[11] See also *Allapattah Servs. v. Exxon Corp.*, 333 F.3d 1248, 1261-62 (11th Cir. 2003) (“The UCC therefore rejects the common law rule that parol evidence is admissible only where the terms of a contract are ambiguous.”).