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The Sale of Electricity in a Deregulated Industry: Should Article 2 of the Uniform Commercial Code Govern

Jason B. Myers

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THE SALE OF ELECTRICITY IN A DEREGULATED INDUSTRY: SHOULD ARTICLE 2 OF THE UNIFORM COMMERCIAL CODE GOVERN?

*Jason B. Myers**

TABLE OF CONTENTS

I. EXTANT AUTHORITY	1053
A. RELEVANT CODE PROVISIONS	1053
B. ELECTRICITY CASES ADDRESSING THE CODE	1054
1. <i>Cases Finding That Electricity Is a Good Under the Code</i>	1054
2. <i>Cases Finding That Electricity Is Not a Good Under the Code</i>	1056
C. RELATED PRODUCT LIABILITY CASES	1062
II. DECIPHERING THE RELEVANT RULES	1064
A. INCORRECT AND INCOMPLETE ANALYSES.....	1064
B. RELEVANT RATIONALES REGARDING THE SALE OF ELECTRICITY	1068
1. <i>Is Electricity a Thing?</i>	1068
2. <i>Is Electricity Moveable?</i>	1070
3. <i>Is Electricity Identifiable to a Contract?</i>	1070
4. <i>Assessing the Effect of Code Section 2-314</i>	1071
III. LEGAL AND POLICY ISSUES ARISING FROM THE DEREGULATION OF THE ENERGY INDUSTRY	1075
A. OVERVIEW: THE STATUS OF DEREGULATION	1075
B. POLICY ISSUES	1077
1. <i>Deregulated States</i>	1077
2. <i>States That Choose Not to Deregulate</i>	1081
C. LEGAL ISSUES IN A DEREGULATED INDUSTRY	1083
1. <i>Power Surges and Voltage Delivery Problems</i>	1083
2. <i>Retail Buyers' Remedies Under the Code in a Deregulated Industry</i>	1085

* B.S., Illinois State University; M.A., University of Illinois; J.D. Candidate (2001), Southern Methodist University School of Law; and former Vice President of Mercer Asset Management Corp., an independent hydroelectric power producer based in Albany, New York. Starting in September 2001, the author will be associated with the Dallas office of Vinson & Elkins, L.L.P. The author would like to thank Professor Roy Ryden Anderson, Professor Victoria A. Farrar-Myers, and F. Michael Tucker. This Comment won the *SMU Law Review's* 2000 Baker & McKenzie Best Comment Award.

IV. CONCLUSION 1086

AFTER decades of being subject to government regulation, the energy industry in the United States has started to undergo a dramatic change. Since the early 1900s, vertically integrated utilities that generate, transmit, and distribute electricity have received exclusive franchise areas in exchange for accepting extensive state regulation over such business issues as the rates that they could charge customers, the expenses that their shareholders would have to absorb, and the capital expenditures that they could make. Now, state legislatures and regulatory bodies throughout the nation, spurred on by the promise of lower energy prices, have started to move away from this monolithic environment toward a more competitive one. As part of the deregulation of the energy industry, energy users—industries, businesses, and residential customers alike—will be given the choice of which company or companies will meet their energy needs.

As a result of these changes, the sale of electricity will be altered as well. In the regulated environment, a utility would charge its customers rates pursuant to a tariff approved by the state regulatory body with governing authority over the company.¹ In the emerging deregulated environment, the sale of electricity will become increasingly subject to competitive-based electricity contracts that will require the parties to manage their risks.² Moreover, utilities will no longer be solely responsible for meeting their customers' energy needs. Although utilities will continue to be regulated monopolies in regard to transmission and distribution ("T&D") services, scores of companies will start competing with each other to supply electricity to industry, business, and residential consumers. This process of unbundling—that is, separating the responsibility for generating electricity from that of transmitting and distributing it—represents one of the primary changes within the deregulating energy industry.³

1. In most states, this body is usually called the Public Service Commission (e.g., New York, Maryland, Michigan) or the Public Utility Commission (e.g., California, Texas, Pennsylvania).

2. See generally Mark E. Haedicke, *Competitive-Based Contracts for the New Power Business*, 17 ENERGY L.J. 103 (1996); Paul J. Pantano, Jr., *Electric Power: Managing Legal Risk in a New Commodity Market*, 19 FUTURES & DERIVATIVES L. REP. 1 (1999).

3. Unbundling generation can take two forms. With corporate unbundling, the entity responsible for transmitting and distributing electricity would not own any generating facilities. Utilities would be required to divest their portfolio of generating assets. On the other hand, under a functional unbundling framework, the utility could own generating facilities, but must establish sufficient internal and accounting controls to treat the generating component as if it were separate from the company's T&D functions. See generally 61 Fed. Reg. 21,540, 21,551 (1996) (Federal Energy Regulatory Commission Order 888). Both forms of unbundling are being used in deregulating the energy industry. For the purposes of this Comment, however, the generic term "unbundling" will be used to refer to both corporate and functional unbundling.

Parties seeking to control their risks related to the sale of electricity in the changing industry may want their contracts governed by Article 2 of the Uniform Commercial Code (“Code”) and the stability it offers.⁴ But before participants in the deregulated industry can rely on the Code as they execute and perform on competitive-based contracts, a key preliminary issue must be addressed: whether the Code applies to the sale of electricity. As will be discussed below, courts have split on this question in the context of electricity supplied by vertically integrated utilities. As the relationships among energy suppliers, energy users, and other market participants change and develop within the evolving energy industry, this question is likely to continue to arise. Thus, as these parties seek to define their contractual relationships, the question of the Code’s applicability to electricity will become increasingly important.

This Comment examines this fundamental question. Part I surveys the rationales courts have used when they addressed the issue in the regulated, utility-dominated environment. In Part II, these rationales are critically evaluated to determine the appropriate method for analyzing whether the Code should govern the sale of electricity. After considering public policy arguments on both sides, the Comment determines that the Code should govern the unbundled sale of electricity. Finally, this Comment considers some of the legal issues that may arise under the Code in the deregulated industry.

I. EXTANT AUTHORITY

A. RELEVANT CODE PROVISIONS

The key legal question to determine when considering whether the Code applies to the sale of electricity is whether electricity is a good or service. Because the Code governs transactions in goods,⁵ electricity must be considered a good for the Code to apply. On the other hand, if the sale of electricity were classified as a service, it would be controlled by a state’s legal rules regarding service contracts. Therefore, the Code’s definition of a “good,” as well as other related terms, will drive the analysis of applying the Code to the sale of electricity.

The Code defines the term “goods” to mean “all things (including specially manufactured goods) which are movable at the time of identification to the contract for sale.”⁶ It also requires that “[g]oods must be both existing and identified before any interest in them can pass.”⁷ The parties can explicitly agree to the manner in which goods are identified to a con-

4. Note, however, that applying the Code in a regulated environment may have increased the legal exposure of energy suppliers. See Jane P. Mallor, *Utility “Services” Under the Uniform Commercial Code: Are Public Utilities in for a Shock?*, 56 NOTRE DAME L. REV. 89, 119 (1980).

5. See U.C.C. § 2-102 (2000).

6. U.C.C. § 2-105(1) (2000).

7. U.C.C. § 2-105(2) (2000).

tract.⁸ Otherwise, identification takes place either at the time of contract for previously existing and identified goods⁹ or, in the case of future goods, “when goods are shipped, marked or otherwise designated by the seller as goods to which the contract refers.”¹⁰ A “sale” occurs under the Code upon “the passing of title from the seller to the buyer for a price.”¹¹ Title passes upon the seller’s physical delivery of the goods to a destination or upon shipment, depending on the terms of the contract.¹²

B. ELECTRICITY CASES ADDRESSING THE CODE

A number of courts have directly addressed whether the Code governs the sale of electricity. But no clear position has emerged. The courts are split on whether electricity constitutes a service or a “good” under the Code. In the following overview of these cases, emphasis placed on the rationales that the courts have used to reach their conclusion. Some attention is also paid to the facts of certain cases. The events that have resulted in these cases—power surges, contact with power lines, breach of contract, just to name a few—will continue to take place in the deregulated energy industry as well, so it is useful to understand the contexts in which the issue of whether electricity constitutes a good or service arises.

1. Cases Finding That Electricity Is a Good Under the Code

In *Helvey v. Wabash County REMC*,¹³ Helvey sought to recover damages caused to his 110-volt household appliances when the power company supplied electricity of 135 or more volts.¹⁴ The trial court granted summary judgment for the REMC on the grounds that the Code’s four-year statute of limitations for damage to personal property barred Helvey from bringing his claim.¹⁵ Helvey appealed, averring that the sale of electricity constituted a service; therefore, the Code did not apply.¹⁶ As a result, he was entitled to a six-year statute of limitations.¹⁷

The Indiana Court of Appeals first noted that electricity can be owned, bartered, sold, stolen, and taxed.¹⁸ Moreover, for electricity to constitute a “good” under the Code, it must be “(1) a thing; (2) existing; and (3) movable, with (2) and (3) existing simultaneously.”¹⁹ The court held that electricity satisfies these elements.²⁰ It debunked Helvey’s contention

8. See U.C.C. § 2-501(1) (2000).

9. See U.C.C. § 2-501(1)(a) (2000).

10. U.C.C. § 2-501(1)(b) (2000).

11. U.C.C. § 2-106(1) (2000).

12. See U.C.C. § 2-401(2)(a), (b) (2000).

13. 278 N.E.2d 608 (Ind. Ct. App. 1972).

14. *Id.* at 609.

15. See *id.* (citing IND. CODE § 26-1-2-725 (1971)); see also U.C.C. § 2-725(1) (2000) (“An action for breach of any contract for sale must be commenced within four years after the cause of action has accrued.”).

16. See *Helvey*, 278 N.E.2d at 610.

17. See *id.*

18. See *id.* (citations omitted).

19. *Id.*

20. See *id.*

that electricity is not movable by referencing the monthly power bill all customers receive from the power company.²¹ Specifically, it concluded that “[l]ogic would indicate that whatever can be measured in order to establish the price to be paid would be indicative of fulfilling both the existing and movable requirements of goods.”²² Thus, since the sale of electricity constituted a transaction of goods, the Code’s statute of limitations provision governed.

*Bellotti v. Duquesne Light Co.*²³ presented a mirror image of *Helvey*. In *Bellotti*, the plaintiff contended that electricity constituted a good to take advantage of the Code’s four-year statute of limitations, which was two years longer than the statute of limitations governing Pennsylvania tort law.²⁴ *Bellotti* claimed that a power surge that entered his residence breached the Pennsylvania Code’s implied warranties of merchantability²⁵ and of fitness for a particular purpose.²⁶

The court found Duquesne Light’s contention that it provided a service to be inconsistent with Pennsylvania case law.²⁷ The court drew upon the Pennsylvania Superior Court’s decision in *Schriner v. Pennsylvania Power & Light Co.*,²⁸ which addressed whether electricity constituted a “product” in a product liability tort case.²⁹ In *Schriner*, the court distinguished electricity that remained in the utility’s T&D system from electricity that had passed through the customer’s meter.³⁰ Only electricity that passed through the customer’s meter could be considered a “product.”³¹ Reasoning by analogy, the *Bellotti* court “assume[d] that the rationale which supported the *Schriner* . . . holding would also govern the issue of when electricity is a ‘good’ within the meaning” of the Code.³²

21. *See id.*

22. *Helvey*, 278 N.E.2d at 610.

23. 4 U.C.C. Rep. Serv. 2d 1393 (Allegheny County 1987) (Court of Common Pleas of Pennsylvania).

24. *Id.* at 1394 (footnote 1 summarizes Pennsylvania’s statute of limitations period for negligence actions).

25. *See id.* (citing 13 PA. CONS. STAT. § 2314); *see also* U.C.C. § 2-314(1) (2000) (“a warranty that the goods shall be merchantable is implied in a contract for their sale if the seller is a merchant with respect to goods of that kind”).

26. *See Bellotti*, 4 U.C.C. Rep. Serv. 2d at 1394 (citing 13 PA. CONS. STAT. § 2315); *see also* U.C.C. § 2-315 (2000) (“Where the seller at the time of contracting has reason to know any particular purpose for which the goods are required and that the buyer is relying on the seller’s skill or judgment to . . . furnish suitable goods, there is . . . an implied warranty that the goods shall be fit for such purpose.”).

27. *See Bellotti*, 4 U.C.C. Rep. Serv. 2d at 1394.

28. 501 A.2d 1128 (Pa. Super. Ct. 1985).

29. *See Bellotti*, 4 U.C.C. Rep. Serv. 2d at 1394 (discussing *Schriner*).

30. *See Schriner*, 501 A.2d at 1134 (by passing through the customer’s meter, the electricity has entered the “stream of commerce”).

31. *See id.*

32. *Bellotti*, 4 U.C.C. Rep. Serv. 2d at 1395. The *Bellotti* court also referenced *Wivagg v. Duquesne Light Co.*, 20 U.C.C. Rep. Serv. 597, 598-602 (C.P. Pa. Allegheny County 1975), which acknowledged that the sale of electricity is a sales-service hybrid transaction and extended the Code’s implied warranties to the sale of electricity for public policy reasons.

The distinction between "electricity in its raw state . . . [and] metered amounts passing through utility-owned conduits and into the homes of consumers" has developed into an important criterion for determining whether the Code applies to the sale of electricity.³³ Courts have used this distinction to find that the post-metered form of electricity is a "good" under the Code³⁴ and that the pre-metered form is not governed by the Code.³⁵ But the pre- and post-metering distinction, while important and useful, is not dispositive in determining whether electricity is a good or a service.

2. Cases Finding That Electricity Is Not a Good Under the Code

As noted above, some courts have declined to consider pre-metered electricity a "good" as defined in the Code. In such cases, the electricity remained in the utility's T&D system at the time of the incident that gave rise to the alleged cause of action. For example, in *Singer Co. v. Baltimore Gas & Elec. Co.*,³⁶ the plaintiff sued for damages associated with a series of power interruptions.³⁷ The outages were traced to "multiple failures on the underground [distribution] cable."³⁸ According to the court, "raw high voltage electricity contained in a utility company's distribution system . . . has not yet been converted into a useable state of lower voltage . . . [and] is not the refined product that the customer intends to buy."³⁹ For these reasons, the court held that pre-metered electricity was not a "good" as defined in the Code.⁴⁰

A Texas court of appeals followed similar reasoning to hold that "the transmission of electrical energy along high tension power lines which eventually leads into a transformer is not goods."⁴¹ In *Navarro County Elec. Coop. v. Prince*, the plaintiff made contact with the electric cooperative's overhead transmission line as he was adjusting a television antenna.⁴² As a basis for his action, Prince claimed that the transmission lines were not adequate packaging for the electricity and thus violated the implied warranty of merchantability in section 2.314 of the Texas Busi-

33. *Cincinnati Gas & Elec. Co. v. Goebel*, 502 N.E.2d 713, 715 (Ohio Mun. 1986); see also Mallor, *supra* note 4, at 95 ("In utility supply contracts identification occurs, at the very latest, when the utility product is drawn through the customer's meter.").

34. See *Cincinnati Gas*, 502 N.E.2d at 715.

35. See *Hedges v. Public Serv. Co.*, 396 N.E.2d 933, 936 (Ind. Ct. App. 1979) ("In *Helvey* we had no problem finding a sale of goods because the electrical current has passed through the meter . . . [but] the tragic escape of 7200 volts from the transmission wire [before the electricity passed through the meter], through the ladder, and into the bodies of these men is not a transaction in goods . . .").

36. 558 A.2d 419, 421 (Md. Ct. Spec. App. 1989).

37. *Id.* at 421.

38. *Id.* at 423 (quoting from a letter from Baltimore Gas & Electric to Singer).

39. *Id.* at 424 (citing *Hedges* and *Cincinnati Gas*).

40. See *id.* (affirming the trial court's decision to dismiss the plaintiff's Code warranty claims).

41. *Navarro County Elec. Coop. v. Prince*, 640 S.W.2d 398, 400 (Tex. Civ. App.—Waco 1982, no writ).

42. *Id.* at 399.

ness and Commerce Code.⁴³ The court considered section 2.314's elements of merchantability, including whether electricity was a fungible good and whether it was adequately packaged or labeled.⁴⁴ It concluded that electrical energy was not a fungible good nor could it be packaged or labeled adequately. Since electricity failed to meet these statutory elements, the court held that "the sale of electric energy would more fittingly be termed the rendition of a service."⁴⁵ In *Houston Lighting & Power Co. v. Reynolds*,⁴⁶ however, the Supreme Court of Texas faced the question of first impression of whether electricity was a product for the purposes of tortious product liability.⁴⁷ The court noted a conflict between *Navarro County* and another court of appeals decision, *Erwin v. Guadalupe Valley Elec. Coop.*,⁴⁸ which assumed without discussion that the sale of electricity involved a product. The *Houston Lighting* court, in holding that electricity is a product, stated that "[e]lectricity is a commodity, which, like other goods, can be manufactured, transported and sold."⁴⁹ As a result, the Texas Supreme Court rejected that part of the *Navarro County* holding that considered electricity to be a service.⁵⁰ Thus, although *Navarro County*'s value as precedent in Texas mostly has been negated, the court's analysis regarding the sale of electricity, in light of the language of the Code's implied warranties provision, offers one approach for considering whether the Code should apply.

Other courts have not provided such a detailed analysis reflecting the basis for their decision that electricity is not a "good" as defined by the Code. For example, in *Buckeye Union Fire Ins. Co. v. Detroit Edison Co.*, a Michigan court of appeals agreed with the trial court's holding that "because of the properties or character of electricity, it is not a good" under the Code.⁵¹ The court, however, did not elaborate as to which properties

43. *See id.*; *see also* U.C.C. § 2-314 (2000).

44. *See Navarro County*, 640 S.W.2d at 400; *see also* U.C.C. § 2-314(2)(b) (2000) ("Goods to be merchantable must be at least such as . . . in the case of fungible goods, are of fair average quality within the description."); U.C.C. § 2-314(2)(e) (2000) ("Goods to be merchantable must be at least such as . . . are adequately contained, packaged, and labeled as the agreement may require.").

45. *Navarro County*, 640 S.W.2d at 400.

46. 765 S.W.2d 784 (Tex. 1988).

47. *Id.* at 785.

48. 505 S.W.2d 353 (Tex. Civ. App.—San Antonio 1974, writ ref'd n.r.e.).

49. *Houston Lighting*, 765 S.W.2d at 785 (citing *Pierce v. Pacific Gas & Elec. Co.*, 212 Cal. Rptr. 283, 290 (Cal. Ct. App. 1985)).

50. The *Houston Lighting* court, however, did not hold that the Code applies to the sale of electricity; nor has any subsequent Texas case. *But cf.* *Grace v. Zimmerman*, 853 S.W.2d 92, 96 (Tex. App.—Houston [14th Dist.] 1993, writ denied) (in a case after *Houston Lighting*, the court applied *Navarro County*'s conclusion that electricity is not goods under the Code in a case involving sewer rights).

51. *Buckeye Union Fire Ins. Co. v. Detroit Edison Co.*, 196 N.W.2d 316, 317 (Mich. Ct. App. 1972). Nevertheless, the court determined that if the electricity that passed through a customer's meter was defective, it was inherently dangerous in nature. Therefore, the concepts of implied warranties of fitness and merchantability, borrowed from the Code, should apply to the sale of electricity. *Id.* at 318 (including footnote 4). The *Buckeye Union* court's application of Code provisions to a service provides an example of using the Code by analogy. *See* Mallor, *supra* note 4, at 96 ("[This] approach . . . applies or refuses to apply the Code by analogy. Although courts using this approach generally rec-

the trial court was referring. *Buckeye Union* represents one of the earliest cases addressing whether electricity is a good or service. Other courts have cited it as holding that the sale of electricity is a service.⁵² But the court's lack of discussion regarding the properties that make electricity not a good hardly resolves the matter, particularly when the *Houston Lighting* court considered that electricity's properties made it a product.⁵³ The facts of the case as the plaintiff pleaded them⁵⁴ made it very similar to *Helvey*.⁵⁵ *Buckeye Union*, however, ended in a different result from *Helvey* regarding whether electricity is a good or service, presumably because of *Buckeye Union*'s reliance on electricity's unstated properties.

Although *Buckeye Union* did not fully address the issue of electricity's properties, the development of New York case law provides insight into which properties and characteristics would lead a court to conclude that electricity is not a good. *Farina v. Niagara Mohawk Power Corp.*⁵⁶ was the first New York case that addressed the characteristics of electricity.⁵⁷ The court noted several characteristics of electricity that led it to conclude that the doctrine of strict product liability did not apply to the case at bar. These characteristics included the fact that electricity that remains in the utility's T&D system "is not in a marketable state."⁵⁸ In addition, the court referred to electricity as "[a] subtle agency that pervades all space and evades successful definition."⁵⁹ Based primarily on its review of other cases and commentaries, the court found that electricity was not a product for the purposes of strict product liability.⁶⁰ In regard to the plaintiff's Code-based claims, the *Farina* court first rejected a claim based on Code section 2-318 regarding third party beneficiaries of a seller's warranty.⁶¹ The court found that no sale occurred. Therefore, the utility was not a seller, and Code Section 2-318 did not apply.⁶² Finally, in dismissing the plaintiff's remaining causes of action, the court stated with no other discussion "we are unable to conclude that it was intended that

ognize some element of service in utility supply contracts, they consider the sales-service distinction to be irrelevant.").

52. See, e.g., *Cincinnati Gas*, 502 N.E.2d at 714; *Navarro County*, 640 S.W.2d at 400.

53. See *Houston Lighting*, 765 S.W.2d at 785.

54. See *Buckeye Union*, 196 N.W.2d at 317-19. In *Buckeye Union*, a fire caused by an electrical arc that passed along the defendant's distribution line into the house allegedly destroyed the plaintiffs' house. The court determined that the plaintiff did not sufficiently support his allegations.

55. See *Helvey*, 278 N.E.2d at 609.

56. 438 N.Y.S.2d 645 (N.Y. App. Div. 1981).

57. See *id.* at 646-47. The plaintiff's husband was killed after he touched an antenna to an overhead power line owned by Niagara Mohawk. The trial court rejected the utility's motion to dismiss *Farina*'s claims of breach of warranty under the Code and strict product liability.

58. *Id.* (citing *Genaust v. Illinois Power Co.*, 343 N.E.2d 465 (Ill. 1976)).

59. *Farina*, 438 N.Y.S.2d at 647 (quoting *BALLENTINE'S LAW DICTIONARY*).

60. See *Farina*, 438 N.Y.S.2d at 647 (citations omitted).

61. See *id.*; see also U.C.C. § 2-318 (2000) (Alternative C: "A seller's warranty . . . extends to any person who may reasonably . . . be affected by the goods and who is injured by the breach of the warranty.").

62. See *Farina*, 438 N.Y.S.2d at 647.

electricity be included within the definition of 'goods.'"⁶³

This last statement provided sufficient authority for two courts following New York law to dismiss other Code-based claims, even without assessing any factual differences between *Farina* and their cases.⁶⁴ Finally, in *Bowen v. Niagara Mohawk Power Corp.*,⁶⁵ a products liability case, the court recognized the factual distinction between *Farina* and the case at bar where "the electricity had passed through the customer's electric meter."⁶⁶ It also considered the properties and characteristics of electricity that led it to conclude that electricity, even in its post-metered form, was a service and not a good or product. Borrowing heavily from an Ohio case,⁶⁷ the *Bowen* court stated:

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." 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 the use of electricity.⁶⁸

These characteristics of electricity may have been similar to the unstated properties relied on by the *Buckeye Union* court.

*Ecogen Four Partners, L.P. v. Niagara Mohawk Power Corp.*⁶⁹ offered a different fact scenario, but one where the court concluded that electricity did not constitute a good without much discussion. Instead of a lawsuit between a utility and a retail customer, *Ecogen* involved the wholesale sale of electricity from independent power producers ("IPPs") to the utility.⁷⁰ Although the case involved several issues, the key Code-related matter stemmed from *Niagara Mohawk*, a regulated utility that

63. *Id.*

64. See *United States v. Consolidated Edison Co.*, 590 F. Supp. 266, 269 (S.D.N.Y. 1984) ("[I]n New York; electricity is not considered 'goods' and the U.C.C. therefore is not directly applicable to contracts involving the provision of electricity."); *Zoller v. Niagara Mohawk Power Corp.*, 525 N.Y.S.2d 364, 367 (N.Y. App. Div. 1988) ("Under [*Farina's*] authority, the . . . breach of warranty cause of action was also properly dismissed."). In these cases, unlike in *Farina*, the events that gave rise to the alleged causes of action occurred after the electricity had passed through the customer's meter, but neither court considered that distinction.

65. 590 N.Y.S.2d 628 (N.Y. App. Div. 1992).

66. *Id.* at 631.

67. See *Otte v. Dayton Power & Light Co.*, 523 N.E.2d 835 (Ohio 1988).

68. *Bowen*, 590 N.Y.S.2d at 631-32 (quoting *Otte*, 523 N.E.2d at 838; full citation omitted).

69. 914 F. Supp. 57 (S.D.N.Y. 1996).

70. *Id.* at 58-60. The plaintiffs, *Ecogen Four Partners, L.P.* and *Norcon Power Partners, L.P.*, both had long-term power purchase agreements with *Niagara Mohawk*. These contracts provided for a higher power sales rate in the early portion of the contract and lower rates in the later periods. When the economics of the agreement did not match original projections, *Niagara* threatened to stop its performance on the power purchase agreements unless the IPPs provided adequate assurances that they would fulfill their respective obligations under the agreements. *Ecogen* filed the original suit, which *Norcon* later joined, seeking among other things a declaratory judgment that the utility had no grounds to seek adequate assurances from *Ecogen*. *Niagara Mohawk* counterclaimed averring that it did have such grounds. See *id.* at 59-60.

serves upstate New York, seeking adequate assurance of future performance from two IPPs (Ecogen Four Partners, L.P. and Norcon Power Partners, L.P.) under Code section 2-609.⁷¹ Citing the authority discussed above, the court stated that the sale of electricity constitutes a service under New York law and, as a result, rejected applying the Code to the power purchase agreements.⁷² Nevertheless, after extensive litigation on appeal, Niagara Mohawk won the right to demand adequate assurances from Norcon. The New York Court of Appeals extended the provisions of Code section 2-609 to complex commercial contracts not governed directly by the Code, such as the Norcon-Niagara Mohawk power purchase agreement.⁷³

Like *Ecogen Four, Rural Elec. Convenience Coop. v. Soyland Power Coop.*⁷⁴ involved a wholesale transaction rather than a retail sale of electricity. The plaintiff ("RECC"), an Illinois non-profit cooperative that distributed electricity to approximately 4,000 customers, entered into an agreement to purchase all of its electricity from Western Illinois Power Cooperative, Inc. ("WIPCO").⁷⁵ After WIPCO merged with the defendant, Soyland, RECC sought to terminate its obligations to purchase electricity from WIPCO/Soyland. RECC based its claim in part on Illinois' Code, which prohibits "the delegation of duties of performance sales contracts."⁷⁶ The court rejected applying the Code in this way "because the sale of electricity [from Soyland to RECC] . . . is not a sale to the ultimate consumer even if the voltage has been reduced by a transformer before it enters RECC's lines and even though it goes through a meter as RECC receives it."⁷⁷ Thus, the RECC decision apparently hinged on the fact that this was a wholesale transaction. Moreover, the

71. See *id.* at 60-61; see also U.C.C. § 2-609(1) (2000) ("When reasonable grounds for insecurity arise with respect to the performance of either party the other may . . . demand adequate assurance of due performance . . .").

72. See *Ecogen Four*, 914 F. Supp. at 61. The court also noted the irony that Niagara Mohawk, who successfully argued in *Farina, Zoller, and Bowen* that electricity was a service, now sought the benefit of the Code by claiming that electricity was a good. *Id.* at 62.

73. See *Norcon Power Partners, L.P. v. Niagara Mohawk Power Corp.*, 705 N.E.2d 656, 662 (N.Y. 1998). To trace the history of this litigation, see *Ecogen Four* 914 F. Supp. at 57; *Norcon Power Partners, L.P. v. Niagara Mohawk Power Corp.* 110 F.3d 6 (2d Cir. 1997) (Niagara Mohawk's appeal of the *Ecogen* decision as it related to Norcon); *Norcon Power Partners, L.P. v. Niagara Mohawk Power Corp.*, 681 N.E.2d 1293 (N.Y. 1997) (certification of the question posed by the Second Circuit); *Norcon*, 705 N.E.2d at 656 (answer to the certified question); and *Norcon Power Partners, L.P. v. Niagara Mohawk Power Corp.*, 163 F.3d 153 (2d Cir. 1998) (employing the New York Court of Appeals answer). Niagara Mohawk and Norcon eventually resolved their dispute when Niagara bought out the above-market portion of its contract with Norcon. See *NiMo Announces Buyout of Norcon Power Contract*, ALBANY TIMES-UNION, Dec. 9, 1999.

74. 606 N.E.2d 1269 (Ill. App. Ct. 1992), *appeal denied*, 616 N.E.2d 346 (Ill. 1993).

75. See *id.* at 1270-71.

76. *Id.* at 1271 (citing Ill. Rev. Stat. 1991, ch. 26, par. 2-210(1)); see also U.C.C. § 2-210(1) (2000) ("A party may perform his duty through a delegate . . . unless the other party has a substantial interest in having the original promisor perform or control the acts required by the contract.").

77. *Id.* at 1275.

court explicitly rejected the metering distinction that other courts have used to find the sale of electricity to constitute a good.

*ZumBerge v. Northern States Power Co.*⁷⁸ involved damages to the plaintiffs' cows resulting from stray voltage.⁷⁹ Although the trial court found that electricity constituted a "good" under the Code, "the decision to treat electricity as subject to [Code] Article 2 [was] a legal question as yet unsettled in Minnesota."⁸⁰ Moreover, the *ZumBerge* court stated that the lower court's decision did not control the level of damages that the *ZumBerges* could recover. The stray voltage and its resulting damages "did not 'arise' from [a] transaction [between the parties], but from actions outside and independent of the transaction."⁸¹ In other words, the stray voltage involved in the case at bar was distinct from the electricity that the *ZumBerges* purchased. The court's unstated conclusion was that the Code did not apply to the stray voltage.⁸²

In addition, the court had another reason for not applying the Code to the case at bar. The court distinguished between a "'commercial transaction' . . . generally defined as a transaction governed by [Code] Article 2"⁸³ and "consumer transactions based on the relative sophistication and bargaining power of the parties."⁸⁴ The court further referenced a concern, which the Minnesota Supreme Court previously expressed, that "Code remedies were inadequate where a consumer lacked bargaining power."⁸⁵ As a result, "any 'transaction' between [the parties] should not fall within the 'commercial transaction' definition as used in *Hapka* so as to preclude [the plaintiffs'] recovery on tort theories."⁸⁶ Thus, largely for public policy reasons, the court excluded the *ZumBerges*' cause of action from being governed by the Code to allow them to recover for damages in tort.⁸⁷

Finally, a superior court of Massachusetts grounded its analysis of whether electricity is a "good" under the Code in public policy considerations.⁸⁸ Specifically, the court evaluated how regulating utilities affected the policy goals underlying product liability law:

78. 481 N.W.2d 103 (Minn. Ct. App. 1992) (review denied April 29, 1992).

79. *See id.* at 105.

80. *Id.* at 107.

81. *Id.* at 108.

82. *See id.*; *see also* *G & K Dairy v. Princeton Elec. Plant Bd.*, 781 F. Supp. 485, 490 (W.D. Ky. 1991) (holding that "stray voltage is not a 'good,' because: (1) electricity is not a good; and/or (2) stray voltage does not pass through the customer's meter").

83. *ZumBerge*, 481 N.W.2d at 107 (citations omitted).

84. *Id.* at 108 (citing *Hapka v. Paquin Farms*, 458 N.W.2d 683 (Minn. 1990)).

85. *See ZumBerge*, 481 N.W.2d at 108; *accord Hapka*, 458 N.W.2d at 688 ("[W]e continue to regard the [Code] remedies as something less than adequate in the ordinary consumer transaction.").

86. *Id.* at 108.

87. *Id.* The court's discussion related to the Economic Loss Doctrine developed in Minnesota case and statutory law. For a discussion of this Doctrine's development in Minnesota, *see Marvin Lumber & Ceder Co. v. PPG Indus.*, 34 F. Supp. 2d 738, 742-43 (D. Minn. 1999).

88. *See New Balance Athletic Shoes, Inc. v. Boston Edison Co.*, 29 U.C.C. Rep. Serv. 2d 397, 398-99 (Mass. Super. 1996).

The court seeks to protect the public by policing companies who participate in the open market. The court accomplishes this policing by imposing a duty on companies to prevent the release of defective products onto the market. The reasons underlying this important role may not be as compelling in cases involving public utilities, since public utilities in many respects cannot be compared to companies competing on the open market to sell a product. Public utilities are subject to stringent regulations. . . . Thus, public utilities do not slip easily into the category of companies that require the imposition of product liability to adequately protect the consumer.⁸⁹

Based on this reasoning, the court found that electricity did not constitute a good.⁹⁰ Thus, a power surge that caused a fire at the plaintiff's facility did not constitute a breach of the Code's warranty provisions.⁹¹

As this review of cases demonstrates, courts have presented a variety of reasons for why the Code should not govern the sale of electricity. These rationales range from a straightforward application of the pre-meter/post-meter test to more complex approaches concerning the characteristics of electricity or the nature of the interaction between a utility and its customers or suppliers. The variety of rationales, as well as causes of action, found in these cases reflects the component roles that utilities traditionally have performed: generation, transmission, and distribution. As these roles are separated from each other in the deregulated environment, strictly adhering to a single position, such as New York courts have done, may no longer be appropriate.

C. RELATED PRODUCT LIABILITY CASES

The issues raised by applying the Code to the sale of electricity are similar to those involved in product liability cases. The concepts "product" and "good" are nearly synonymous. As a result, plaintiffs in many cases have sought recovery under both product liability and Code-based claims.⁹² Moreover, courts have used their analysis for one type of claim in addressing the other.⁹³ Electricity product liability cases are more prevalent, and more studied,⁹⁴ than Code-based cases. While not all theories addressed in these cases should be used in a Code-based analysis,⁹⁵

89. *Id.* at 399 (quotations and citations omitted).

90. *Id.*

91. *Id.*

92. *See, e.g., Farina*, 438 N.Y.S.2d at 646-47.

93. *See, e.g., Bellotti*, 4 U.C.C. Rep. Serv. 2d at 1394-95.

94. *See, e.g.,* Roger W. Holmes, Note, *Strict Products Liability for Electric Utility Companies: A Surge in the Wrong Direction*, 29 SUFFOLK U. L. REV. 161 (1995); Louis Lawrence Boyle, Comment, *Electrifying Solutions for the Shocking and Disparate Treatment of Electricity Within Product Liability Law*, 93 DICK. L. REV. 851 (1989); Allen L. Rutz, Comment, *After the Meter: Energy Products Liability in a Deregulated Environment*, 26 CAP. U. L. REV. 421 (1997).

95. For example, the stream of commerce theory is one of the principle approaches used in electricity product liability cases. One particular variation of this theme holds that "an electric utility's mere placement of electricity into the stream of commerce suffices for a products liability action." Holmes, *supra* note 94, at 179. Moreover, some courts have held that "electricity may enter the stream of commerce when the electric company relin-

one can examine product liability cases to understand better the arguments used in determining whether electricity is a good under the Code.

Two product liability cases in particular can flush out the discussion above regarding the characteristics and properties of electricity. In *Ransome v. Wisconsin Elec. Power Co.*,⁹⁶ the Supreme Court of Wisconsin provided an often-cited passage in which the court concluded that electricity is a product:

While there probably are numerous technical definitions of "electricity," we need not be concerned with those accurate descriptions here suffice it to say it is a form of energy that can be made or produced by men, confined, controlled, transmitted and distributed to be used as an energy source for heat, power and light and is distributed in the stream of commerce. The distribution might well be a service, but the electricity itself, in the contemplation of the ordinary user, is a consumable product.⁹⁷

In this passage, not only did the *Ransome* court lay out what it considered electricity's relevant characteristics, it also analytically unbundled electricity from the other roles that a regulated utility played. It viewed a utility's function in generating electricity separate and distinct from its T&D roles.

On the other end of the spectrum, in *Otte v. Dayton Power & Light Co.*,⁹⁸ the Supreme Court of Ohio viewed electricity as falling outside the definition of the term "product," which is "anything made by human industry or art."⁹⁹ The court found that the utility did not manufacture the electricity.¹⁰⁰ Instead, it merely put "in motion the necessary elements that allow the flow" of electrically charged particles.¹⁰¹ Moreover, the electric charges that the utility releases at its generating stations are significantly different than those that the end-user receives.¹⁰² Specifically, the electricity's voltage is stepped-up so it can be transmitted across high voltage power lines and then stepped-down to be distributed to the consumer. Thus, "electric power cannot be considered a product intended to reach the consumer in the same condition in which it is released at a power plant."¹⁰³

quishes exclusive control over its product." *Aversa v. Public Serv. Elec. and Gas Co.*, 451 A.2d 976, 980 (N.J. Super. Ct. Law Div. 1982). While this line of reasoning may be appropriate for a product liability case, it likely would fail in a Code-based claim. The Code does not focus on whether the seller has exclusive control, but instead on whether the good has been identified to a contract for sale, as required by U.C.C. § 2-105. See *infra* Part II(B)(3) regarding identifying electricity to a contract.

96. *Ransome v. Wisconsin Elec. Power Co.*, 275 N.W.2d 641 (Wis. 1979).

97. *Id.* at 643.

98. *Otte v. Dayton Power & Light Co.*, 523 N.E.2d 835 (Ohio 1988).

99. *Id.* at 838.

100. See *id.*

101. *Id.*

102. See *id.* at 839.

103. *Id.* (relying on RESTATEMENT (SECOND) OF TORTS § 402A(1)(b), which requires a product to reach the end-user "without substantial change in the condition in which it is sold"). The *Otte* court considered other characteristics of electricity. The *Bowen* court in

II. DECIPHERING THE RELEVANT RULES

A. INCORRECT AND INCOMPLETE ANALYSES

As the discussion above shows, courts have used numerous rationales or criteria for deciding whether electricity is a good or service. But not all the criteria were used correctly, particularly in applying the Code. Before one can properly decide whether electricity is a good, the incorrect rationales that some courts have employed need to be dismissed. In addition, numerous courts have used analytical short-cuts to reach otherwise correct results. For example, they have not explicitly provided the legal theory underlying their analysis or have made unstated leaps in logic. By doing this, these cases leave open the possibility that subsequent judges may misinterpret their precedent, thus potentially leading to developing more incorrect legal doctrines. Thus, the incomplete analyses need to be flushed out completely.

First, the Code does not distinguish between the type of end-user, or whether the transaction is at the wholesale or retail level. Code Section 2-103(1)(a) defines the term "buyer" to mean "a person who buys or contracts to buy goods."¹⁰⁴ Thus, the *ZumBerge* court's distinction between commercial and consumer transactions¹⁰⁵ is inappropriate. The Code covers consumer transactions as well as sophisticated commercial transactions.¹⁰⁶ The *ZumBerge* court worked around the scope of the Code's "buyer" definition by finding that stray voltage was not part of the transaction between the *ZumBerges* and the utility.¹⁰⁷ But the court's commercial/consumer distinction is without basis in the Code. If the sale of electricity constitutes a sale of goods, then the buyer of the electricity is irrelevant; the Code should govern that transaction.

Similarly, the *RECC* court should not have rejected applying the Code on the grounds that the sale was not to the "ultimate consumer."¹⁰⁸ The Code does not require "buyers" of goods to use them for their own ends, but allows buyers to become sellers later. A wholesale transaction between two power companies or cooperatives, such as the one in *RECC*, should be viewed as a sale between merchants.¹⁰⁹ The Code defines the term "merchant" in part as "a person who deals in goods of the kind . . . involved in the transaction."¹¹⁰ In *RECC*, both cooperatives dealt in

New York incorporated a portion of this analysis. See discussion *supra* notes 65-68 and accompanying text.

104. U.C.C. § 2-103(1)(a) (2000).

105. See *ZumBerge*, 481 N.W.2d at 108.

106. See E. ALLAN FARNSWORTH, *CONTRACTS* (3d ed.) § 1.10, at 38 (1999) ("Thus the Uniform Commercial Code . . . does not exclude consumers.").

107. See *ZumBerge*, 481 N.W.2d at 108.

108. *RECC*, 606 N.E.2d at 1275.

109. Along the same lines, the power purchase agreements in dispute in the *Ecogen Four/Norcon* cases also would be considered a sale between merchants if New York courts applied the Code to the sale of electricity. See *supra* notes 69-73 and accompanying text.

110. The complete definition of a "merchant" is:

a person who deals in goods of the kind or otherwise by his occupation holds himself out as having knowledge or skill peculiar to the practices or goods

electricity—in terms of both their specific contract as well as generally. The Code clearly intended to incorporate sales between merchants within its scope, as indicated by the fact that certain provisions apply only in such transactions.¹¹¹

A second erroneous line of reasoning relates to how some courts described the kilowatt-hour as a measure of a customer's electricity usage. Both the *Otte* and *Bowen* courts regarded the kilowatt-hour as a time measurement.¹¹² Consumers paid the utility based on the length of time that they used electricity; thus, they effectively were paying for an hourly service. This understanding of the kilowatt-hour, however, is incorrect. Despite what the term may imply, the kilowatt-hour does not measure the time of usage, but instead the amount of electricity used.

A kilowatt-hour can be defined as “[t]he basic unit of electric energy equal to one Kilowatt of power supplied to an electric circuit steadily for one hour.”¹¹³ The equivalent amount of energy can be calculated in many other ways: two Kilowatts supplied for one-half hour, three Kilowatts supplied for 20 minutes, etc. The energy provider, therefore, is not compensated by the time it supplies energy, but instead the quantity. None other than Thomas Edison, the father of the electrical distribution system, understood this fact: “I had to devise a system of metering electricity . . . so that I could measure the *amount* of electricity used by each consumer.”¹¹⁴ This proper view corrects the *Otte/Bowen* courts' misunderstanding of the kilowatt-hour and works to negate their argument that electricity is a service. Moreover, it actually supports the view that electricity is a good. Because electricity can be described in quantified amounts, it can be more easily identified to a contract as required under Code section 2-105.

Third, courts must be careful to specify why the pre-metered form of electricity may not be a good under the Code. The key reason is that electricity in the power lines probably has not been identified to a contract, as required under the Code. But the court in *Singer Co. v. Baltimore Gas & Elec. Co.*, for example, improperly relied on the argument that such electricity had not “been converted into a useable state.”¹¹⁵ Similarly, in *Farina*, the court considered electricity in the power lines to

involved in the transaction or to whom such knowledge or skill may be attributed by his employment of an agent or broker or other intermediary who by his occupation holds himself out as having such knowledge or skill.

U.C.C. § 2-104(1) (2000).

111. See, e.g., U.C.C. § 2-201(2) (2000) (“Between merchants . . .”); see also FARNSWORTH, *supra* note 106, at 37.

112. See *Bowen*, 590 N.Y.S.2d at 631-32 (quoting *Otte*); *Otte*, 523 N.E.2d at 838 (“[Consumers] pay for each kilowatt hour provided. Thus, consumers are charged for the length of time electricity flows through their electrical systems.”).

113. State of New York Department of Public Service, *A Glossary of Terms Used by Utilities and Their Regulators*, available at <http://www.dps.state.ny.us/glossary.html>. It is equal to approximately 3,450 Btu. See *id.*

114. Quoted in JAMES A. COX, *A CENTURY OF LIGHT* 28 (1979) (emphasis added).

115. *Singer Co.*, 558 A.2d at 424.

not be in a “marketable state.”¹¹⁶

The distinction of whether electricity is in a marketable state is essential in a product liability case.¹¹⁷ But the official comment to the Code’s provision regarding identification states “there is no requirement in this section that the goods be in a deliverable state or that all of the seller’s duties with respect to the processing of the goods be completed in order that identification occur.”¹¹⁸ Thus, the fact that electricity may not be in a usable form does not preclude the Code from governing the transaction; it indicates only that the seller may not have fulfilled all of its contractual obligations. Moreover, nothing in the Code prevents parties from agreeing that electricity in its unusable state, while still in a utility’s power lines, will be identified to a contract. Absent such a specific agreement that defines when the electricity is identified, however, metering provides the best method to identify electricity to a contract. Thus, the fact that electricity may not be marketable at any certain point is not relevant for a Code-based analysis; what matters is whether electricity is identified to a contract. The pre-metered distinction speaks to this element.

Finally, and perhaps most importantly, courts generally have failed to address the point that the sale of electricity from a regulated utility involves a sales-service hybrid transaction. The sale of electricity includes something that resembles a product and that is consumed by end-users. It also includes the necessary services of transmitting the electricity from generating stations and distributing it to those consumers. Although most courts have not discussed the sale of electricity in terms of a hybrid transaction, they have implicitly employed standard analytical tools in deciding whether the Code applied.

The primary means for assessing whether Article 2 of the Code should govern a sales-service transaction is the “predominant factor” test, where a court will consider which component of the transaction—the goods or the service—is dominant.¹¹⁹ Thus, if the sale of goods were the dominant component, then the Code would apply. Conversely, Article 2 would not apply if the service were the predominant factor in the transaction.

Although many commercial transactions may fall clearly toward one component or the other, some transactions fall within a gray area.¹²⁰ In such situations, Professor Hawkland suggests that “it might be more sensible and facilitate administration . . . to abandon the ‘predominant factor’ test and focus instead on whether the *gravamen* of the action involves goods or services.”¹²¹ That is, if the essential part of the plaintiff’s com-

116. *Farina*, 438 N.Y.S.2d at 646 (citations omitted).

117. *See, e.g., Genaust*, 343 N.E.2d at 470 (“[T]he doctrine of strict liability was not intended to encompass injuries resulting from a ‘product’ which is in an unmarketable state. . .”).

118. U.C.C. § 2-501 cmt. 5 (2000).

119. *See* 1 WILLIAM D. HAWKLAND, UNIFORM COMMERCIAL CODE § 2-102:4 (1998).

120. *See id.*

121. *Id.* (emphasis added).

plaint stems from a defective good, for example, then the Code would govern *that* complaint; if the complaint involves service-related damages, the Code would not apply in *that* situation.¹²² Thus, the gravamen test is fact-specific and requires determining the primary cause of the plaintiff's damages.

As noted above, some courts seemingly have used the principles underlying the predominant factor and gravamen tests to analyze the sale of electricity without adopting them explicitly.¹²³ For example, in both *Helvey* and *Bellotti*, the sale of electricity constituted a good despite the fact that the cause of action stemmed from service-related problems (excess voltage and a power surge respectively).¹²⁴ To reach this result, the courts must have believed that the sale of the goods dominated the utilities' distribution services within the transaction. Otherwise, the appropriate issue before the court would have been whether the utility was negligent in delivering the electricity. Thus, these cases represent an implicit use of the predominant factor test.

Along the same lines, the *ZumBerge* court distinguished that the plaintiffs' cause of action stemmed from the utility's "failure to control . . . injurious stray voltage."¹²⁵ Thus, the complaint rested outside the sale of electricity and related to Northern States Power's T&D services. In other words, even though the trial court held that the sale of electricity constituted a transaction in goods, the gravamen of the complaint was based on a service. Therefore, the Code did not apply.

One should note that these courts did not necessarily decide the cases incorrectly. But the lesson to be culled from these decisions is that a court should be more precise and explicit in its analysis. The rationales underlying these decisions will be employed in new contexts as the energy industry deregulates. Thus, even though the conclusions in these cases may be right, one's ability to use them to analyze disputes that will arise in the deregulated context is limited unless one also considers the underlying basis for the decisions.

122. Hawkland uses as an example the case of *Worrell v. Barnes*, 484 P.2d 573 (Nev. 1971), in which the plaintiff sued for damages caused by a fire. The fire stemmed from a gas leak from a valve that connected a propane tank to a water heater that the defendant installed. Hawkland states that if the court in *Worrell* employed the gravamen test, then "if the gas escaped because of a defective fitting or connector, the case might be characterized as one involving the sale of goods. On the other hand, if the gas escaped because of poor work by Barnes the case might be characterized as one involving services, outside the scope of the UCC." HAWKLAND, *supra* note 119, at § 2-102:4.

123. *But cf. Cincinnati Gas*, 502 N.E.2d at 714. Here, the court started its analysis by stating that "the test for the inclusion in or the exclusion from the scope of the term 'goods' is whether the *predominant factor* and purpose of the contract is the rendition of service with goods incidentally involved or whether the contract is for the sale of goods with service incidentally involved" (emphasis added). The court's analysis, however, did not turn on the dominant essence of the transaction, but instead on whether post-metered electricity was a good.

124. *Bellotti*, 4 U.C.C. Rep. Serv. 2d at 1394-95; *Helvey*, 278 N.E.2d at 609-10.

125. *ZumBerge*, 481 N.W.2d at 108.

B. RELEVANT RATIONALES REGARDING THE SALE OF ELECTRICITY

Surprisingly enough, no court has worked through the Code's three elements defining a good (a thing, movable, and identifiable) to determine whether electricity satisfies those elements. The *Helvey* court came closest to accomplishing this task, when it noted that electricity must be "(1) a thing; (2) existing; and (3) movable, with (2) and (3) existing simultaneously."¹²⁶ But *Helvey's* requirement that electricity exist is not the same as it being identifiable.¹²⁷ A thing can exist without it being identifiable, a good example being the wind. Being identifiable implies that the thing has a tangible quality, thus excluding intangible items from the Code's coverage.¹²⁸ Therefore, while *Helvey's* cursory overview is a useful starting place, the issue of whether the Code governs the sale of electricity, considered separately from T&D services, requires a more systematic analysis of the elements of a good.

1. *Is Electricity a Thing?*

The term "thing" provides a vague standard for understanding how to satisfy this element. One could presume that this term was intended to be interpreted fairly broadly, and therefore does not necessarily present a significant barrier to applying the Code to a transaction. For example, the *Helvey* court did not even discuss whether electricity was a "thing," instead focusing its attention on the other elements of a good.

The "thing" element would seem to be designed to exclude services from the Code's scope. But providing electricity clearly is not solely a service, since the customers consume the electricity that comes into their homes or businesses.¹²⁹ Therefore, some other basis must be found if electricity is to fail to satisfy the Code's requirement that it be a "thing"—and that basis may be that electricity is not sufficiently tangible to be considered a "thing" within the Code's scope.

As noted above, the Code seeks to circumscribe the scope of transactions in tangible goods.¹³⁰ Therefore, if electricity cannot be considered tangible, then it cannot be a good. Thus, the Code would not govern its sale. The existing case law provides only a narrow basis for determining whether electricity is tangible. Two products liability cases have summa-

126. *Helvey*, 278 N.E.2d at 610.

127. The *Helvey* court apparently blended Code sections 2-105(1) and 2-105(2). The former sets forth the definition of a good, which requires it to be a thing, moveable, and identified to a contract. The latter conditions the passing of interest in goods on their being existing and identifiable. See U.C.C. § 2-105(1)-(2) (2000).

128. The Code's "purpose is to avoid making practical issues between practical [people] turn upon the location of an *intangible something*." U.C.C. § 2-101 cmt. (2000) (emphasis added). See also HAWKLAND, *supra* note 119, at § 2-105:2 ("The exclusion of 'things in action' and the inclusion of 'things which are movable' suggests that Section 2-105 limits goods to tangible personal property.").

129. Providing electricity, at least in the context of a vertically integrated utility, is best seen as a sales-service hybrid transaction. See *supra* note 32, and notes 119-22 and accompanying text.

130. See *supra* note 128 and accompanying text.

rily described electricity's nature as "intangible."¹³¹ For the most part, however, courts have not addressed this point directly.

Arguments can be made on both sides of this point. On one hand, electricity may be considered as an invisible force that stems from electrically charged particles. Indeed, the full definition of electricity found in *Ballentine's Law Dictionary* (cited in part in *Farina*¹³²) is: "A subtle agency that pervades all successful definition. A dangerous, invisible, subtle, silent, deadly, and instantaneous *force*."¹³³ It is akin to a magnetic force; their effects can be seen, but the actual phenomenon itself cannot.¹³⁴ Clearly, one would not consider magnetism to be a good because of its intangible qualities. Using the same line of reasoning, electricity should not be considered a tangible good.

Although this reasoning may have a certain intuitive appeal, it does have limitations as well. While electricity may not be seen, it "can be felt and otherwise observed."¹³⁵ Moreover, one could argue that if tangibility is defined in terms of having the ability to be perceived by the senses, then electricity is tangible and should be a good under the Code.¹³⁶ Perhaps the most distinguishing fact in determining electricity's nature is that it can be measured (*i.e.*, otherwise observed) through the use of a meter. Unlike other natural forces like magnetism or the wind, which can be measured only indirectly through its force or speed, one can meaningfully and directly quantify the *amount* of electricity that passes through a meter.¹³⁷ Thus, even though one may believe electricity to be an evasive and invisible force, the better reasoned approach is to consider electricity to be tangible.

Moreover, the legal argument that electricity is not tangible would not stand up against the weight of judicial authority. Regardless of *Ballentine's* artful definition, electricity has specific physical properties that would bring it within the Code's requirement that it be a "thing."¹³⁸ Even those courts that have not found electricity to be a product or a good would not dispute that it is, at least, a "thing." For example, the

131. See *Elgin Airport Inn, Inc. v. Commonwealth Edison Co.*, 410 N.E.2d 620, 623 (Ill. App. Ct. 1980) ("Because electricity is intangible, . . . the intangible force of electrical current is not a 'product.'"), *rev'd on other grounds*, *Elgin Airport Inn, Inc. v. Commonwealth Edison Co.*, 432 N.E.2d 259, 262 (Ill. 1982) ("[T]here is no need to consider the more fundamental questions . . . , such as whether electricity is a product at all. . . ."); *Williams v. Detroit Edison Co.*, 234 N.W.2d 702, 705 (Mich. Ct. App. 1975) ("[W]e note that the 'product' involved in this case is not a tangible item like an automobile Rather, it is a form of energy").

132. See *supra* note 59.

133. *BALLENTINE'S LAW DICTIONARY* 395 (3d ed. 1969) (emphasis added).

134. See, e.g., *Cox*, *supra* note 114, at 22 (In 1600, William Gilbert published a book stating the fundamentals of magnetism, calling the mysterious force "electrica.").

135. *HAWKLAND*, *supra* note 119, at § 2-105:2.

136. See *id.*

137. This fact highlights the importance of understanding what a kilowatt-hour measures. See *supra* notes 112-14 and accompanying text.

138. Consider the more technical definition of electricity in *Webster's Dictionary*: "a property of certain fundamental particles of all matter. . . ." *WEBSTER'S NEW WORLD COLLEGE DICTIONARY* 436 (3d ed. 1997).

Otte and *Bowen* courts referred to electricity as electrically charged *particles*.¹³⁹ In *Singer Co.*, the court distinguished between raw voltage and the “refined product” customers buy.¹⁴⁰ This distinction would not make sense if electricity were merely a natural force; that is, electricity could not be a “raw” force as well as be found in a “refined” state. Finally, in *Austin v. Public Serv. Co. of Northern Ill.*,¹⁴¹ the case from which *Ballentine’s* derived its definition, the Illinois Supreme Court referred to electricity as a commodity.¹⁴² Given these views, electricity would seem to fall clearly within the Code’s first element for determining whether it is a good.

2. *Is Electricity Moveable?*

This element of a good is the easiest for electricity to satisfy.¹⁴³ No court has rejected applying the Code to electricity on the grounds that it is not movable. Moreover, even the *Otte* court described electricity as the “flow” of electrically charged particles.¹⁴⁴ This “flow” reflects that something is moving from the generating station across the power lines and into the customers’ homes and businesses. Therefore, one should conclude that electricity meets the Code’s element of being movable.

3. *Is Electricity Identifiable to a Contract?*

To some degree, the issue of electricity’s tangible qualities also affects the analysis of whether electricity can be identified to a contract. If electricity is not tangible, it likely cannot be identifiable. The discussion above addressed this question of tangibility in some detail and need not be repeated here. Suffice it to say, since electricity itself can be measured, it should be considered to have enough tangible qualities that allow it to be identified to a contract. The key question, therefore, is how and when does electricity become identifiable.

The fact that the sale of electricity can be measured by using a meter establishes an easy means to identify electricity to a contract. The meter measures the amount of electrical current either generated at a power plant and released into the distribution system, or consumed by a customer. Moreover, the meter generally is positioned at or near the point that divides two parties’ property interests.¹⁴⁵ This placement also pro-

139. *Bowen*, 590 N.Y.S.2d at 631-32; *Otte*, 523 N.E.2d at 838 (emphasis added).

140. *Singer Co.*, 558 A.2d at 424.

141. *Austin v. Public Serv. Co. of Northern Ill.*, 132 N.E. 458 (Ill. 1921).

142. *Id.* at 460.

143. This element also is important to the Code’s conception of a good: “The definition of goods is based on the concept of movability. . . .” U.C.C. § 2-105 cmt. 1 (2000).

144. *Otte*, 523 N.E.2d at 838.

145. For example, the meter at most residences is located on an outside wall of the house and is connected to the utility’s distribution line. Furthermore, contracts between IPPs and utilities often will require that the meter be located at the point where the IPP delivers the electricity into the utility’s transmission system. Moreover, if the meter is not located at that specific point, the meter readings will be adjusted to offset for line losses of electricity that invariably happen. See, e.g., Agreement Between Fourth Branch Associates

vides a convenient location where the risk of loss can switch from one party to the other, an issue that is particularly important at the wholesale transaction level.¹⁴⁶ Thus, electricity would seem to be identifiable to a contract at the point where a meter measures it.

This conclusion, taken with the conclusion that electricity is both a thing and is movable, leads one to find that electricity meets the Code's definition of a good as specified in section 2-105. Certainly, a court could reject this conclusion based on a finding that electricity is intangible. But this analysis has shown that most of the premises used to reject applying the Code to the sale of electricity either (1) have been incorrect, or (2) are not as strong as the arguments supporting the use of the Code. While other factors need to be assessed to determine ultimately whether to apply the Code, electricity has met the fundamental threshold issue: it should be considered a good.

4. *Assessing the Effect of Code Section 2-314*

Although electricity would appear to satisfy the Code's definition of "goods," other Code sections may affect whether and how the Code should apply to the sale of electricity. As the earlier review of cases demonstrated, some courts have rejected applying the Code because electricity failed to meet specific elements of certain sections.¹⁴⁷ The most significant of these cases was *Navarro County*, where the court concluded that electricity failed to meet the Code's statutory elements for merchantability in section 2-314.¹⁴⁸ This Code section provides that "[u]nless excluded or modified, a warranty that the goods shall be merchantable is implied in a contract for their sale if the seller is a merchant with respect to goods of that kind."¹⁴⁹ Apparently, the *Navarro County*

and Niagara Mohawk Power Corp. ¶ TENTH (May 7, 1987) (on file with author). This contractual language reads in part "ELECTRICITY delivered by SELLER hereunder shall be measured by electric watt hour meters If the meters are located at a point other than the Point of Delivery, the readings will be adjusted for losses between the metering location and the Point of Delivery." Many state regulatory agencies make power purchase agreements like this one available for public review and copying.

146. See the discussion in the previous footnote regarding adjusting for line losses.

147. Although this portion of the Comment focuses on Code section 2-314, courts also have rejected applying other provisions of the Code to the sale of electricity. For example, the *Farina* court rejected applying section 2-318 regarding third party beneficiaries of warranties on the grounds that a sale had not occurred after the plaintiff's husband touched a power line; therefore, the utility was not a seller as required in that section. This analysis, however, appears to use implicitly the gravamen test. Specifically, because the essence of the cause of action stemmed from the utility's service-related functions (*i.e.*, the location of its transmission lines) instead of its sale of goods functions, the Code would not apply to this transaction. But since New York seemingly has rejected the use of the gravamen test (*see* HAWKLAND, *supra* note 119, at § 2-102:4), the *Farina* court needed to find some other way to reach its conclusion regarding the plaintiff's Section 2-318 claim.

148. *Navarro County*, 640 S.W.2d at 399. As discussed *supra* at notes 41-50 and accompanying text, the *Navarro County* finding that electricity is a service was overturned in a products liability case. But the *Navarro County* court's analysis regarding whether electricity can meet the Code's definition of merchantability is a useful analytical tool for determining whether the Code should apply to the sale of electricity.

149. U.C.C. § 2-314(1) (2000).

court assumed that if a good were incapable of ever satisfying the Code's implied warranty of merchantability, then transactions in those goods should not be covered by the Code.

Section 2-314 sets out six criteria for determining merchantability: passing without objection; in the case of fungible goods, being of fair average quality; being fit for ordinary purposes; running of even kind; being adequately packaged and labeled if required; and conforming to promises made on any labeling.¹⁵⁰ The *Navarro County* court claimed that electricity "certainly could not be classified as fungible goods nor is there any way to adequately package or label electrical energy;"¹⁵¹ thus, electricity apparently failed to satisfy the elements of merchantability. This analysis, however, is incorrect. The Code does not require goods to be fungible or packaged, as the *Navarro County* court implied. Instead, it sets forth certain conditional requirements that must be satisfied if, in fact, the goods are fungible or packaged.

Consider the Code's language. Section 2-314(2)(b) starts "in the case of fungible goods."¹⁵² This language implies that certain goods are fungible while others are not; but the Code covers both types of goods. The provisions regarding packaging and labeling contain similar conditional language. Section 2-314(2)(e) refers to packaging and labeling "as the agreement may require."¹⁵³ Similarly, section 2-314(2)(f) addresses promises "made on the container or label *if any*."¹⁵⁴ Once again, these provisions inform a merchant of goods of what it would need to do if any packaging or labeling either were required or provided. But they do not preclude a good from being subject to the Code merely because it is not or cannot be packaged.

Thus, the *Navarro County* line of reasoning has been refuted. But that still leaves a basic issue to address: whether electricity is capable of meeting the definition of merchantability, provided that the elements of merchantability are analyzed correctly. The Code acknowledges the warranty of merchantability's importance, noting that it "is so commonly taken for granted that its exclusion from the contract is a matter threatening surprise."¹⁵⁵ Therefore, let us consider the elements of

150. U.C.C. § 2-314(2) reads in full:

Goods to be merchantable must be at least such as: (a) pass without objection in the trade under the contract description; and (b) in the case of fungible goods, are of fair average quality within the description; and (c) are fit for the ordinary purposes for which such goods are used; and (d) run, within the variations permitted by the agreement, of even kind, quality and quantity within each unit and among all units involved; and (e) are adequately contained, packaged, and labeled as the agreement may require; and (f) conform to the promise or affirmations of fact made on the container or label if any.

151. *Navarro County*, 640 S.W.2d at 400.

152. U.C.C. § 2-314(2)(b) (2000).

153. U.C.C. § 2-314(2)(e) (2000). The Code's official comment adds that this paragraph "applies only where the nature of goods and of the transaction require a certain type of container, package or label." U.C.C. § 2-314 cmt. 10 (2000).

154. U.C.C. § 2-314(2)(f) (2000) (emphasis added).

155. U.C.C. § 2-314 cmt. 11 (2000).

merchantability as they relate to electricity.

The Code directs that the first two paragraphs in section 2-314(2) should be read together.¹⁵⁶ Regardless of whether electricity is fungible,¹⁵⁷ electricity is capable of passing without objection and of being of fair average quality. Indeed, these elements are met every time a homeowner turns on a light switch, an office worker runs a computer, or a manufacturer operates a massive industrial processing system without any incident. If electricity could not meet these requirements, even daily activities like these could not be done. This same reasoning applies to subparagraphs (c) and (d) regarding being fit for ordinary purposes and running of even kind. Finally, as already discussed, electricity does not need to be packaged or labeled to satisfy the Code's definition of merchantability.¹⁵⁸ Thus, the sale of electricity can be said to satisfy the listed components of merchantability.

Perhaps the more interesting question to consider is whether the sale of electricity, considered separately from T&D services, can ever violate any criteria of merchantability. Or, to put it more simply, is there such a thing as defective electricity in the way that one may buy a broken television, for example. If electricity may not ever breach the warranty of merchantability, would that preclude applying the Code to its sale?

The quality of electricity—that is, the good itself—does not vary. At its essence, electricity is merely charged particles; the *Otte* court stated this premise correctly. Those particles do not vary in terms of whether they are “good electricity” or “bad electricity.” They simply constitute “electricity.”

The case law that has addressed the Code's warranty of merchantability section has done so in the context of service related problems: stray voltage, power surges, excess electricity, etc. The issue regarding section 2-314 becomes this: if the sale of electricity is unbundled from the T&D services, an injured party's cause of action would be against the entity that delivered the electricity. As a result, the Code's warranty of merchantability would be effectively negated as to the sale of electricity because it would never violate the components of merchantability listed in section 2-314. Thus, one could argue that, given

156. U.C.C. § 2-314 cmt. 7 (2000).

157. U.C.C. § 1-201(17) (2000) defines fungible as “goods . . . of which any unit is, by nature or usage of trade, the equivalent of any other like unit.” On one hand, the *Navarro County* court summarily dismissed electricity as not being fungible. But one could make the argument that one unit (*e.g.*, one kilowatt-hour) of electricity is like any other. Therefore, electricity should be considered fungible.

158. The issue of whether electricity is adequately packaged or contained usually arises when a person makes contact with a power line. *See, e.g., Navarro County*, 640 S.W.2d at 399. By unbundling the delivery of electricity from the sale of the good, one sees that issues relating to power lines would fall upon the entity that transmits and distributes electricity, and not the one who sells electricity. Thus, injuries arising from contact with a power line should be considered as a potential tort action, not a breach of implied warranty of merchantability.

the importance of this section,¹⁵⁹ since section 2-314 would not apply to the unbundled sale of electricity, then such transactions should not be governed by the Code.

While this argument (*i.e.*, there is no such thing as “defective electricity”) may start from a meritorious premise, the legal conclusion that the Code should not govern the unbundled sale of electricity does not necessarily follow. First, as discussed above, section 2-314’s primary objective—for goods to be merchantable—is met by the unbundled sale of electricity; the claims that are likely to arise stem from T&D services. Second, while the warranty of merchantability is important in transactions of goods, it is not required to complete a sale. Certainly, the Code itself limits the implied warranty of merchantability only to sales in which the seller is a merchant.¹⁶⁰ In addition, it provides that the warranty of merchantability can be expressly modified or excluded from any transaction.¹⁶¹

But even if the warranty of merchantability were not specifically excluded from a transaction involving a merchant as the seller, the Code’s commentary would seem to imply that the warranty must not necessarily be imputed into *every* transaction. For example, comment 11 to section 2-314 reads: “The warranty of merchantability, wherever it is *normal*.”¹⁶² This statement would seem to indicate that in certain transactions the warranty of merchantability is not normal, and therefore section 2-314 would not apply. Such would be the case with the unbundled sale of electricity.

Moreover, comment 13 starts: “In an action based on breach of warranty, it is of course necessary to show not only the *existence* of the warranty.”¹⁶³ In addition, comment 2 notes that the definition of merchantability varies from trade to trade and that “[t]he question when the warranty is imposed turns basically on the meaning of the terms of the agreement as recognized in the trade.”¹⁶⁴ Once again, the logical inference stemming from these statements would appear to be that for certain transactions the implied warranty of merchantability does not exist. Given this commentary, the Code seems to indicate that for a narrow band of transactions of goods sold by a merchant, section 2-314 does not apply. But the remaining Code provisions, where applicable, would govern the transaction. Thus, to summarize, the question of how and whether section 2-314 should apply to the sale of electricity should not preclude the Code from governing such transactions generally.

159. See U.C.C. § 2-314 cmt. 11 (2000) (“The warranty of merchantability, wherever it is normal, is so commonly taken for granted . . .”).

160. See U.C.C. § 2-314(a) (2000) (“[A] warranty that the goods shall be merchantable is implied in a contract for their sale *if the seller is a merchant* with respect to goods of that kind.”) (emphasis added).

161. See U.C.C. § 2-316 (2000) (Exclusion or Modification of Warranties).

162. U.C.C. § 2-314 cmt. 11 (2000).

163. U.C.C. § 2-314 cmt. 13 (2000) (emphasis added).

164. U.C.C. § 2-314 cmt. 2 (2000).

III. LEGAL AND POLICY ISSUES ARISING FROM THE DEREGULATION OF THE ENERGY INDUSTRY

As discussed in the previous section, the better-reasoned legal analysis is that electricity should be considered a good and that the Code should govern its sale. Courts have not only had to address this legal question, but also the policy considerations of either applying or not applying the Code to the sale of electricity.¹⁶⁵ The intersection between legal and policy considerations will take on a greater meaning as states throughout the nation address the policy decision of whether to deregulate the energy industry within their borders.

A. OVERVIEW: THE STATUS OF DEREGULATION

Although a comprehensive review of the move toward deregulation is beyond the scope of this Comment, an overview of the efforts to date will provide a useful context for understanding the issues that likely will arise regarding the sale of electricity in a deregulated industry. The current movement to allow consumers to choose their energy supplier has its roots in the 1978 Public Utilities Regulatory Policy Act ("PURPA").¹⁶⁶ Although PURPA has been criticized for contributing to higher energy costs,¹⁶⁷ it also has fostered the development of the independent power industry.¹⁶⁸ With this industry now matured, many IPPs can generate electricity at a lower cost than utilities.

Other federal legislative and regulatory decisions have laid a further foundation for deregulating the energy industry.¹⁶⁹ These efforts generally have loosened some regulations for utilities and IPPs so as to make it easier for them to engage in selling their electricity at the wholesale level. On the retail level, however, although numerous bills calling for the deregulation of the industry have been introduced in Congress,¹⁷⁰ none have become law. Leading supporters, however, have continued to push for comprehensive federal legislation that would allow all consumers to

165. See, e.g., *New Balance*, 29 U.C.C. Rep. Serv. 2d at 398-99.

166. Pub. L. No. 95-617, 92 Stat. 3117 (1978).

167. For example, several bills over the years have been introduced in Congress to amend the bill to address this problem. See, e.g., H.R. 1587, 106th Cong. (1999); H.R. 1828, 106th Cong. (1999); and S. 1047, 106th Cong. (1999).

168. Among other things, PURPA requires utilities to purchase electricity from "qualifying facilities" ("QFs") at their avoided costs. 16 U.S.C. § 824a-3 (1994). This provision provided a guaranteed market to QFs at the wholesale level, even though they were precluded from selling directly to consumers. Avoided costs are a utility's "cost of either generating the electricity itself or purchasing it from another source." *Ecogen*, 914 F. Supp. at 59.

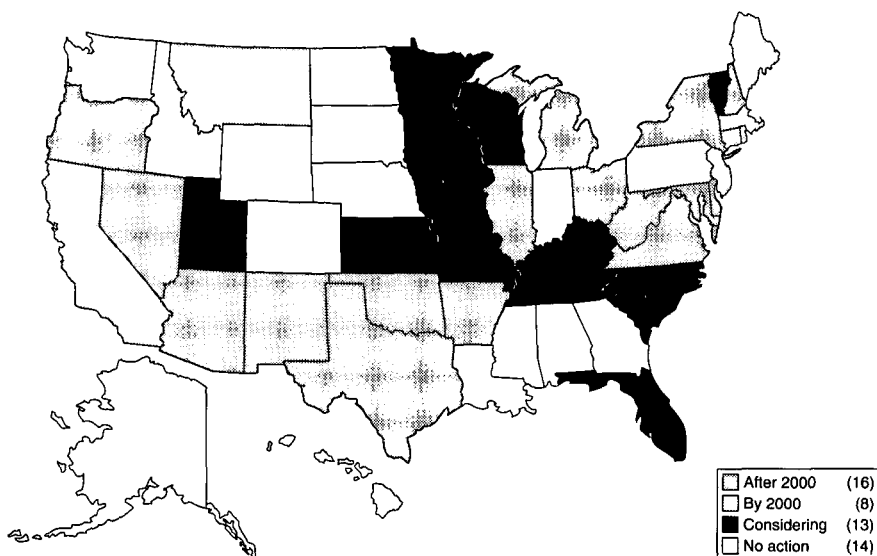
169. See, e.g., Promoting Wholesale Competition Through Open Access Non-Discriminatory Transmission Services by Public Utilities; Recovery of Stranded Costs by Public Utilities and Transmitting Utilities, 61 Fed. Reg. 21,540 (1996) (Federal Energy Regulatory Commission Order 888); Energy Policy Act of 1992, Pub. L. No. 102-486, 106 Stat. 2776 (1992) (easing restrictions on QFs and establishing Exempt Wholesale Generators).

170. See, e.g., Electricity Competition and Reliability Act of 1999, H.R. 2944, 106th Cong. (1999).

choose their electricity supplier.¹⁷¹

In lieu of federal legislation, the decision to deregulate and to allow consumer choice has been made on a state-by-state basis. As Figure 1 shows, the states can be grouped into three categories. A number of states have decided to deregulate the energy industry within their borders. Generally, these are states where the cost of electricity was well above the national average, including California, New York, and Massachusetts. Several states already allow energy consumers their choice in suppliers, while others either have started to open up retail sales to competition or will do so shortly. Either way, consumers will have their choice within the next few years.

FIGURE 1: STATUS OF ELECTRICAL DEREGULATION AS OF SEPTEMBER 1, 2000.



Source: Compiled from National Association of Regulatory Commissioners' Energy Restructuring Database

Note: "By 2000" means that all energy customers have their choice in energy supplier by December 31, 2000. "After 2000" means that all energy users will be allowed to choose their supplier on some date after December 31, 2000, even if some customers already have that choice at the end of the year 2000.

On the other end of the spectrum, a number of states have not embraced the concept of deregulation. In many cases, the state already may

171. For example, Rep. Tom Bliley (R-VA), Chair of the House Committee on Commerce in the 106th Congress, testified before the Subcommittee on Energy and Power that "We have a duty to give consumers access to more choices and lower prices. To deny them this would be wrong." House of Representatives Committee on Commerce, *Bliley Statement on Electricity Competition: State and Local Issues*, available at <http://com-notes.house.gov/ccheat/hearings106.nsf/8eaabcee30ee07ee852566f900700f0d/a0b27b50f5cc5944852567a1004a0bed?OpenDocument> (Press release dated July 1, 1999).

have low energy costs and is concerned that deregulation would result in increased rates.¹⁷² In others, specific circumstances limit the ability to deregulate the industry in the immediate future. For example, Hawaii's geography makes it very difficult to develop a competitive generating industry.¹⁷³ Or consider Nebraska where all the electricity currently comes from public power.¹⁷⁴

Finally, within this spectrum are other states that have considered deregulating the energy industry within their borders, but have not yet made the decision to do so. The support for deregulation in these states varies as well ranging from almost certainly going to deregulate in the next legislative session to a highly skeptical studying of the issues. Thus, the state-by-state decision to deregulate has resulted in a mixed collection of policies and approaches to addressing energy costs.

B. POLICY ISSUES

As seen above, the concept of "deregulating the energy industry" is not as comprehensive as the term might imply. In fact, for several states, the deregulation decision has meant deliberately maintaining the existing vertical-utility-monopoly structure that thus far has produced low-cost power. Therefore, considering the policy issues of applying the Code to the sale of electricity in a deregulated industry requires examining two different policy environments: those states that will allow consumer choice and those that will not.

1. *Deregulated States*

Many states have decided to deregulate the energy industry in an effort to reduce power costs for industry, business, and consumers. Thus, one policy issue for a state to consider is which legal framework will facilitate lower cost power: the Code or that state's statutory and common law of contracts. Admittedly, this question may be answered only in an abstract, theoretical sense. Assume, however, that energy generators will factor uncertainty into the price at which they will be willing to sell their electricity—that is, the more uncertainty a generator may face, the greater its sale price will be. In this regard, the Code generally provides a more certain and well-known set of rules for governing contracts than non-Code contract law. Thus, all things being equal, a generator selling under the Code would have marginally lower risk than one not governed by the

172. For example, the average cost in the State of Washington is 4.1 ¢/kwh. See National Ass'n of Regulatory Util. Comm'rs, *Washington Summary*, available at <http://www.naruc.whatsup.net/customers/naruc/naruc.nsf/wwwStateSummaries/Washington>.

173. See National Ass'n of Regulatory Util. Comm'rs, *Hawaii Summary*, available at <http://www.naruc.whatsup.net/customers/naruc/naruc.nsf/wwwStateSummaries/Hawaii> (NARUC Energy Regulatory Database).

174. See National Ass'n of Regulatory Util. Comm'rs, *Nebraska Summary*, available at <http://www.naruc.whatsup.net/customers/naruc/naruc.nsf/wwwStateSummaries/Nebraska> (NARUC Energy Regulatory Database).

Code. With less risk to factor into its sales prices, the generator should be more willing and able to sell its electricity at a lower price.

Perhaps the best anecdotal evidence of the effect of the Code's certainty can be found in the *Ecogen/Norcon* litigation discussed in Part I(B)(2) *supra*.¹⁷⁵ After an extensive litigation in a state where electricity did not fall within the Code (referred to here as a non-Code state), Norcon was required to provide adequate assurances *as if* it were governed by the Code. In a Code-based state, the legal issue of whether Niagara Mohawk had the right to demand adequate assurances would have been known by both parties up-front; the only question would have been whether the facts of the case warranted Niagara Mohawk's demand. Reasoning back to the abstract by analogy, a generator entering into a sales contract state in a non-Code state would have to figure the potential litigation costs *both* for determining the legal standard for applying adequate assurances *and* whether that standard was met in any given case. A generator in a Code-based state, however, would only have to factor in the latter uncertainty and thus be able to pass the savings onto its customers.¹⁷⁶

The desire for lower energy costs raises another reason supporting the use of the Code to govern the sale of electricity. As the electric industry deregulates, one can assume that the interested parties (*e.g.*, legislators, regulators, utilities, energy producers, energy uses, etc.) would seek to develop the most efficient new rules to reduce power costs. To this extent, the rules, structures, processes, etc. that such interested parties actually are developing treat the sale of electricity in a deregulated industry as transactions in goods.

For example, in May 1999, the Federal Energy Regulatory Commission ("FERC") authorized the California Power Exchange to create a subsidiary to facilitate block-forward trades of power.¹⁷⁷ This subsidiary would match sellers and buyers in "the trading of power for delivery" during hours of peak electrical usage.¹⁷⁸ As another example, the National Association of Regulatory Utility Commissioners commissioned a study in 1998 to help establish the technical criteria necessary to track generation attributes.¹⁷⁹ This study is filled with words that reflect a view of electric-

175. See *supra* notes 69-73 and accompanying text.

176. I should emphasize that I am *not* making the argument that using the Code to govern the sale of electricity will eliminate most or all of the litigation uncertainty associated with interpreting a sales contract. Like any other piece of legislation, the Code will be subject to judicial interpretation that will lead to certain risks. See, *e.g.*, U.C.C. § 1-102 cmt. 1 (2000) ("It is intended . . . for the law embodied in this Act to be developed by the courts. . . ."). Those risks will be factored into a seller's price. The argument that I *am* making is simply that the Code generally provides a more certain set of base rules than those provided by the common law of contracts.

177. See 87 F.E.R.C. 61,203 (Order Accepting for Filing Proposed Block-Forward Market, as Modified).

178. *Id.*

179. See Paul A. Centolella & Craig Miller, *Tracking Generation Attributes for Consumer Disclosure: Technical Criteria for Tracking Systems*, available at <http://www.naruc.org/DownloadableDocuments/tracking.htm>, at 5-8 [hereinafter NARUC Study]. Genera-

ity as a good: electricity resellers, retail generation products, taking title to power, the right to withdraw energy from the power grid, and so on. These terms, as well as the language regarding California's block-forward trading, are used to describe a good—not a service—and that is how the energy industry seems to view the sale of electricity when it is unbundled from T&D services.

By setting up systems such as those just discussed, participants in the deregulating energy industry are seeking in part to promote efficiency¹⁸⁰ to meet the goal proffered by deregulation advocates: to have lower costs for energy consumers. Since industry participants are treating energy as a good as a means to obtain lower costs, public policy concerns would dictate that the law should follow this lead. The Code would do this as it seeks to harmonize commercial law with modern commercial practices.¹⁸¹ The use of the Code is completely compatible with the custom and usage regarding electricity that is currently developing within the energy industry. Thus, for these policy reasons, the Code should govern the sale of electricity in a deregulated industry.

One possible policy reason *against* applying the Code to the unbundled sale of electricity relates to the administrative problems that might arise in doing so. Regardless of how electricity itself is treated, the T&D components of electrical delivery should still be treated as services. As a result, a court might experience certain problems in trying to differentiate between the electricity as a good and T&D as services. The easiest way to avoid such problems, therefore, would be to treat all components of electrical delivery, including generating and selling electricity, as a service.¹⁸² Thus, the Code would not apply.

Furthermore, even if the Code were to govern the sale of electricity, many of its key provisions would be rendered meaningless. As noted above, the Code's implied warranty of merchantability could not be breached. In addition, a buyer would not be able to exercise certain rights that the Code provides, such as being able to reject any goods that do not conform to the contract¹⁸³ or revoke acceptance under specified conditions.¹⁸⁴ With the Code's provisions gutted in this way, its primary

tion attributes include such information as what fuel source was used to generate the electricity as well as its environmental effects. With such a tracking system in place, consumers will be better able to choose, for example, to buy electricity generated using a renewable resource like hydro or solar power. "A credible and effective tracking system for generation products is essential to the development of a differentiated retail supply that will both maximize consumer choice and facilitate the development of clean and renewable generation." *Id.* at 11.

180. *See id.* at 5.

181. U.C.C. §1-102(2) (2000) states in part: "Underlying purposes and policies of this Act are: (a) to simplify, clarify, and modernize the law governing commercial transactions; (b) to permit the continued expansion of commercial practices through custom, usage and agreement of the parties"

182. A court could support this conclusion based on the *Otte* view that electricity is merely the release of charged particles. *See Otte*, 523 N.E.2d at 838.

183. *See* U.C.C. § 2-601 (2000).

184. *See* U.C.C. § 2-608 (2000).

purpose would be for calculating damages. A court likely would achieve the same result in calculating damages by using most jurisdictions' rules for determining damages stemming from the breach of a service contract.¹⁸⁵ Given that some of the Code's most important provisions would not apply to the sale of electricity in any event, and those important ones that do remain are not really different from standard contract law, the Code does not need to be used at all. For these reasons, electricity should be considered a service.

These arguments present a strong case for not employing the Code at all in the sale of electricity. But the Code contains other provisions that can have much bearing on the course of litigating energy-related claims. Remember, for example, that the New York Court of Appeals applied the Code's provision on adequate assurances to the power purchase agreement in dispute in the *Ecogen/Norcon* litigation.¹⁸⁶ In addition, another New York court used the Code's provision regarding output contracts in a different dispute between Niagara Mohawk and several IPPs.¹⁸⁷ In other words, many courts have reasoned by analogy from the Code in areas where that jurisdiction's common law of service contracts is insufficiently developed.¹⁸⁸ Such indirect use of the Code seems inefficient when, as with the unbundled sale of electricity, the Code can apply directly.

In addition, the argument that the Code should not apply to any aspect of generating, transmitting, or selling electricity may provide some simplicity in judicial decision-making. But this argument ignores the reality of the emerging competitive market in the energy industry. First, as discussed above, those in the trade are in fact treating generation as separate and distinct from T&D. Second, and more importantly for litigation purposes, courts will be required to clear certain hurdles to decide some fundamental procedural issues in any energy-related litigation.

Consider the following hypothetical. A consumer files a lawsuit based on a single energy-related claim and lists three defendants: the T&D utility, the company that sold the electricity to the consumer at the retail level, and the generator from whom the seller bought electricity at the wholesale level. Given the different roles that the utility, retail seller, and wholesale generator play in the deregulated industry, only one of them would potentially be liable to the plaintiff. As a result, the lawsuits against the other two defendants would need to be dismissed for failure to state a claim. For example, if the plaintiff's claim were related to the

185. Compare RESTATEMENT (SECOND) OF CONTRACTS § 347 (1981) (comment a: "Contract damages are ordinarily based on the injured party's expectation interest") with U.C.C. §§ 2-703, 2-711 (2000) (the Code's general provisions regarding remedies).

186. See *supra* notes 69-73 and accompanying text.

187. See *Philadelphia Corp. v. Niagara Mohawk Power Corp.*, 621 N.Y.S.2d 237, 238 (N.Y. App. Div. 1995) (citing Code section 2-306 as one reference supporting the proposition that "[o]bligations arising under an output contract are subject to good faith and commercial standards of fair dealing").

188. See *Consolidated Edison*, 590 F. Supp. at 269-70 (noting that New York courts have applied Code provisions in areas where the Code does not govern).

negligent delivery of the electricity, then the rightful defendant would be the utility; the plaintiff would have no claim against either the retail or wholesale sellers. To summarize, the judge would need to separate generation from T&D to determine the essence of the plaintiff's cause of action. Thus, any efficiencies that might be gained by treating the sale of electricity in the deregulated market as a service would never come to fruition.

This hypothetical highlights an important consequence of a state's decision to unbundle generation from T&D services. Deregulation effectively necessitates the use of the gravamen test, if for no other reason to ensure that plaintiffs are suing the correct party. Courts likely will need to apply this test regularly, either explicitly or implicitly, to decide what caused a plaintiff's alleged damages. As a result, there is no longer any prominent barrier against applying the Code to electricity in states that allow consumers to choose their energy supplier. Moreover, given the legal and policy rationales discussed in this Comment, the Code's Article 2 should govern the sale of electricity in a deregulated industry.¹⁸⁹

2. *States That Choose Not to Deregulate*

The conclusion that the Code should govern in a deregulated state only provides a partial answer. The question remains: what should be done in those states that choose not to deregulate. As discussed above, some states believe that their businesses' and citizens' best interests are served by maintaining the current utility-dominated system.

In these states, many of the legal and policy issues are the same as those litigated in the cases discussed in Part I. Thus, certain public policy arguments may still hold, such as those put forth in *New Balance* where the court held that the stringent regulation of utilities precluded the finding that electricity was a good.¹⁹⁰ Moreover, the administrative-ease argument considered in the previous section would carry more weight in a utility-dominated state. Because the utility, and only the utility, interacts directly with end-users in a regulated state, the need to consider the different components of electrical delivery separately dissipates to a large degree. Regardless of the cause of action, end-users' claims will almost always be against the utility. Thus, to simplify energy-related litigation, courts could treat electrical delivery as either a good or a service. And plenty of case law exists to support the latter. Thus, for public policy

189. One should note that even in deregulated states, at least one entity that sells electricity will be subject to state regulation: the provider of last resort. The provider of last resort, usually a regulated utility, is the entity that is obliged to provide electricity to anyone so as to ensure that people do not go without electricity in their homes or businesses. The subject of the provider of last resort raises a host of its own public policy issues as states and energy providers seek to balance the public service of having electricity available to all people with issues of compensation and consumer protection. These issues are beyond the scope here.

190. See, e.g., *New Balance*, 29 U.C.C. Rep. Serv. 2d at 398-99.

reasons, courts in states with vertically integrated, regulated utilities may find that the sale of electricity is a service.

The corollary of this position, however, is whether such policy reasons are sufficient to overcome the legal basis discussed in Part II, *supra*, for finding that the sale of electricity should be considered a transaction in goods even in a regulated state. As noted above, the gravamen test can be used in a regulated environment and would provide a useful means for applying the Code when appropriate to do so. Moreover, since deregulated states will need to employ a gravamen-style analysis to a great deal of energy-related litigation, these decisions will provide judicial guidance to those states that have not deregulated. If a state has rejected using the gravamen test, however, it still could, and perhaps should, find that the sale of goods is the predominant factor in the delivery of electricity. Thus, the Code generally would apply to the sale of electricity. But such a general rule would still allow courts to find ways in which to determine that the Code did not apply in specific instances, such as the *ZumBerge* court did.

The conclusion drawn from these two sets of arguments is that public policy does not tilt strongly in either direction; it favors neither finding that electricity is a service or that it is a good. But these policy arguments hearken back to the old utility-monopoly framework. They do not take into account the fact that, even if one state has retained the old system, many other states and the federal government are moving toward, or at least considering moving toward, a deregulated system premised on customer choice. Within this new framework, an additional public policy concern may arise.

Despite the rhetoric regarding consumer choice, deregulation is primarily about trying to lower energy costs. Those states that have high power rates hope that the advent of competition will reduce these costs. But those states that have low rates either have been skeptical about deregulation or rejected it outright, even though that means energy users in that state cannot choose their energy supplier. These states have decided that the lower energy costs more than compensate for the lack of choice.

If Congress, however, were to pass a comprehensive national deregulation bill, the states' policy choice to keep the monopoly system would be pre-empted by federal law.¹⁹¹ Thus, those states with a regulated utility framework may wish to find ways in which to forestall the need for national legislation. Adopting the Code may provide one means to accomplish this goal. One underlying purpose of the Code is to "to make uniform the law among the various jurisdictions."¹⁹² Thus, regulated states could argue that with uniform treatment of electricity transactions

191. National legislation, however, would not pre-empt state laws regarding contracts or the Code. On another point, although beyond the scope of this Comment, the issue of congressionally mandated consumer choice potentially raises a host of federalism issues related to balancing the federal government's interstate commerce powers and the states' police powers.

192. U.C.C. § 1-102(2)(c) (2000).

under the Code the need for comprehensive national legislation is reduced. While this argument certainly has its limitations,¹⁹³ the flipside is perhaps more persuasive. To the extent that the law relating to the sale of electricity varies across jurisdictions, the need for federal legislation may become more apparent given the fact that transmission lines and power grids extend beyond state boundaries.

Regardless of the approach taken, the result is the same: a state may be better able to preserve its policy choice to keep its utilities regulated if it adopts the Code for the sale of electricity. Moreover, any other policy considerations that would support rejecting the Code can be countered by equally persuasive arguments in the Code's favor. Thus, taken with the legal argument supporting the use of the Code, the better reasoned approach would be to adopt the Code to govern the sale of electricity in states that retain regulated utilities. But note that this conclusion refers only to the sale of the good itself; to the extent possible, the gravamen test should be used to separate those claims that arise due to the utilities' T&D services.

C. LEGAL ISSUES IN A DEREGULATED INDUSTRY

Within this changing environment, new legal issues likely will arise. Similarly, old issues will continue to be litigated, but with new twists. Since the legal and policy arguments above support the contention that the Code should govern transactions involving the unbundled sale of electricity, one should consider how the Code would be used to resolve these legal issues. Thus, we will now consider two selected issues that are likely to arise in the deregulated energy industry, one related to warranties and another related to remedies, as examples of applying the Code in the deregulated industry.

1. *Power Surges and Voltage Delivery Problems*

The issue that may generate the most confusion in the new environment is actually one that has been heavily litigated. Specifically, plaintiffs likely will continue to bring suits for damages associated with power surges, excess voltage, stray voltage, etc. As discussed in the hypothetical in Part II(B)(4), *supra*, a gravamen-style analysis will be necessary to determine who are the proper parties to the case. But this analysis also will help in assessing the proper outcomes of such cases.

Because the Code is assumed to govern the sale of electricity for this discussion, energy merchants would be held strictly liable for any breach of the implied warranty of merchantability under Code section 2-314. But, as discussed above, in cases regarding surges, voltage, etc., the problem would not lie with the merchantability of the goods; the energy merchant presumably provided goods that would still be fit for their ordi-

193. Certainly adopting the Code will not in and of itself forestall national legislation. But it does provide one argument in favor of the states.

nary purpose—that is, run electrical appliances, machines, etc.—which is consistent with the Code’s requirements for merchants. The claim’s essence, however, would go to how the electricity was distributed, thereby bringing in the T&D utility but not the energy merchant.

This distinction may be an overly fine one. At least one commentator (Rutz) has argued that energy merchants should be held to strict product liability for defective energy.¹⁹⁴ Because the product in this case cannot be consumed without using the T&D system, the concept of “defect” for energy could be extended to include “any inadvertent high or low . . . electrical voltage that enters the home due to a distribution system failure.”¹⁹⁵ Reasoning by analogy, this argument conceivably could be used to invoke the Code’s strict liability warranty of merchantability.

This argument, however, is faulty for several reasons regardless of whether it is used in a product-liability case or for a sale under the Code. First, this theory imposes strict liability on energy merchants for something over which they have no control—the effectiveness of the T&D system to deliver the merchants’ goods.¹⁹⁶ The Code’s warranty of merchantability requires that a plaintiff establish both causation in fact and proximate causation for any breach of warranty.¹⁹⁷ In these surge and voltage problems, the functioning of the T&D utility’s delivery system would step into the line of causation to become the proximate cause of the energy consumers’ damages; the line of proximate causation between the energy merchant and the buyer would be severed.

Rutz contends that the issue of holding energy merchants liable for the T&D utility’s service can be resolved by allowing a merchant to seek contribution from the utility for negligence and requiring those parties to determine the essence of the plaintiff’s claim.¹⁹⁸ Herein lies the second problem with this theory. By bringing in the T&D utility only as a third party defendant while imposing strict liability on energy merchants, this approach adds unnecessary costs and inefficiencies to both the sale of energy and the legal system.

The T&D utility is compensated for regulating the delivery of electricity into energy users’ homes and businesses. The cost of doing so, which would include costs associated with any liability arising from negligent operations, will be incurred and passed onto ratepayers regardless of the legal standard used. Likewise, energy merchants will pass on their costs so as to maintain a comfortable profit margin. But here the legal standard does matter. If energy merchants are subject to strict liability, but can seek contribution from the utility, the costs associated with both ex-

194. See Rutz, *supra* note 94, at 448-50.

195. *Id.* at 448.

196. Rutz acknowledges that his approach would hold “the energy merchant subject to liability for defects in the delivery system.” *Id.* at 447.

197. See JAMES J. WHITE & ROBERT S. SUMMERS, UNIFORM COMMERCIAL CODE § 9-9 (4th ed. 1995); U.C.C. § 2-314 cmt. 13 (2000) (“[I]t is . . . necessary to show . . . that breach of the warranty was the proximate cause of the loss sustained.”).

198. See Rutz, *supra* note 94, at 447.

posure to liability and defending themselves ultimately will be reflected in the price charged to consumers. These latter costs, however, do not need to be incurred and indeed should not be. The key factual *and* legal question in any surge/voltage situation will be whether the T&D utility was negligent. Energy users will pay the costs associated with the utility's negligence in any circumstance. Imposing the additional costs associated with strict liability for energy merchants results in all consumers paying twice for the utility's negligence.

The primary reason for pursuing the strict-liability-for-energy-merchants theory is to protect energy users so that individual plaintiffs would be made whole for any damages caused by surges/voltage. As just seen, however, all energy users ultimately bear these costs. The more efficient and legally proper avenue is for aggrieved energy users to pursue recovery for damages directly against the T&D utility for the surge/voltage. Courts and state legislatures could decide whether such claims require utility negligence or if they would invoke some form of strict liability consumer protection warranty;¹⁹⁹ such a policy consideration is beyond the scope of this Comment. But one point is clear: energy merchants should not be held strictly liable for damages caused by the delivery of their otherwise merchantable goods.²⁰⁰

2. *Retail Buyers' Remedies Under the Code in a Deregulated Industry*

Regardless of the cause of action, any litigation eventually turns to the issue of remedies. Although the general issues to be discussed will be nothing new for students of the Code's approach toward remedies, their use in the deregulated energy environment requires a certain focus. For purposes here, I will consider a retail buyer's economic loss stemming from the breach of contract as a means to highlight this issue.

Generally when a seller breaches a contract for sale, the buyer has a choice.²⁰¹ It may "cover" by purchasing substitute goods and seek damages measured by the "difference between the costs of cover and the contract price."²⁰² Or the buyer may seek damages associated with the non-delivery of goods equal to the difference between the contract and market prices.²⁰³

The reality surrounding the retail sale of electricity in a deregulated environment generally will mean that buyers will not seek damages for

199. See, e.g., *Buckeye Union*, 196 N.W.2d at 318.

200. Based on this reasoning, cases where someone accidentally touches a power line clearly should not involve an energy seller. This case would relate to where the lines were located and how they were constructed and maintained. Here, the argument is even stronger that the energy merchant had nothing to do with the cause of action and, therefore, should not be considered liable. Moreover, if the T&D utility happens also to sell electricity, the case should be based on its role as a T&D provider, not as a merchant in goods.

201. See U.C.C. § 2-712 cmt. 3 (2000) ("[T]he buyer is always free to choose between cover and damages for non-delivery.").

202. U.C.C. § 2-712(1) (2000).

203. See U.C.C. § 2-713 (2000).

non-delivery. No energy user simply will go without using electricity until the dispute with the breaching seller is resolved. Instead, consumers will immediately cover—that is, purchase electricity either from the competitive market or from the provider of last resort.²⁰⁴

The immediacy of purchasing covering electricity has a more significant effect beyond dictating under which Code provision the buyer would sue. Code section 2-715 allows aggrieved buyers to incidental and, more significantly, consequential damages stemming from any breach.²⁰⁵ Buyers normally will try to recover consequential damages such as lost profits and loss of goodwill.²⁰⁶ But the Code also “bars recovery for losses that could have been prevented by cover.”²⁰⁷

Thus, suppose a firm loses business because its supplier failed to deliver goods under a contract. Further, assume that the firm could reasonably acquire substitute goods within one week. Generally, that firm would be allowed to recover consequential damages equal to one week’s lost profit, but would be barred from recovering for profits beyond that because such damages could reasonably have been mitigated. In the context of purchasing electricity at the retail level, however, cover usually will occur immediately.²⁰⁸ Situations may exist where the seller breaches during a brownout period where electricity demand greatly outpaces supply and the provider of last resort has an insufficient supply as well. In such situations, a person may not be able to find a seller immediately. But absent such extenuating circumstances, aggrieved buyers generally will have no basis to seek consequential damages such as lost profits following a seller’s breach.

IV. CONCLUSION

The law regarding the commercial sale of electricity traditionally has been subject to less-than-precise legal analysis. In any litigation that arose in the regulated environment, the case invariably involved a utility that generated, transmitted, and distributed electricity. Courts did not need to distinguish clearly whether electricity should or should not be considered a good, whether the sale of electricity was dominated by the good or the service, or what the essence of the plaintiff’s claim was. Nor did they need to explain their conclusions in great detail.

The advent of the deregulated energy industry, however, will change this tendency for cursory analysis. With an increase in the number of industry participants, the complexity of energy transactions, and the amount of money that could be at stake, courts will need to sort out many detailed factual and legal issues, and then be ready to explain the out-

204. See *supra* note 189 regarding the provider of last resort.

205. See U.C.C. § 2-715 (2000).

206. See WHITE & SUMMERS, *supra* note 197, at § 6-5.

207. *Id.* See also U.C.C. § 2-715(2)(a) (2000) (“[A]nd which could not reasonably be prevented by cover or otherwise.”).

208. In the case where it may not, the seller likely would argue that substitute electricity reasonably could be purchased immediately.

comes. While certainly not an intended consequence of deregulation, the resulting improvement in jurisprudence stemming from it should be welcome by those in the industry.

Upon a proper analysis of the Code, one thing should be clear: the unbundled sale of electricity is a transaction in goods and, therefore, should be subject to the Code. The difficulties that will arise, however, will stem from trying to reconcile this conclusion with existing case law, particularly in jurisdictions that have found the sale of electricity in the regulated environment to be a service. While previous cases certainly cannot and should not be discarded on a whim, their value as precedent may be limited. The deregulated energy industry—more precisely, that component of the industry that is subject to competition—is a very different structure than the one dominated by monopolies. It also seeks to promote a different set of policy goals than the century-old model of regulation. Therefore, many of the underlying facts and premises from existing case law simply will not be found in cases that arise in the deregulated environment. Thus, like the industry itself, the law governing the industry may need to change.

New York State may provide the best barometer of whether such a change will take hold. Despite occasionally applying Code provisions by analogy,²⁰⁹ New York has perhaps the strongest line authority rejecting the application of the Code to electricity in a regulated environment. But it also has been one of the states on the forefront of deregulation. As a result, it faces the greatest tension in trying to reconcile the old and the new.

209. See, e.g., *Norcon*, 705 N.E.2d at 662 (discussed *supra* at note 73 and accompanying text); *Philadelphia Corp.*, 621 N.Y.S.2d at 238 (discussed *supra* at note 187 and accompanying text).

