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13 UNITED STATES BANKRUPTCY COURT
14 NORTHERN DISTRICT OF CALIFORNIA
15 SAN FRANCISCO DIVISION

16 In re

17 PACIFIC GAS AND ELECTRIC
18 COMPANY, a California corporation,

19 Debtor.

20 Federal I.D. No. 94-0742640

No. 01 30923 DM

Chapter 11 Case

Date: May 16, 2001

Time: 9:30 a.m.

Place: 235 Pine St., 22nd Floor
San Francisco, California

21 DEBTOR'S NOTICE OF MOTION AND MOTION FOR
22 AUTHORITY TO PAY PRE-PETITION PROPERTY TAXES

23 [SUPPORTING MEMORANDUM OF POINTS AND AUTHORITIES
24 AND DECLARATION OF CHARLES M. MARRE
25 FILED SEPARATELY]

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18 MEMORANDUM OF POINTS AND AUTHORITIES
19 IN SUPPORT OF MOTION FOR ORDER AUTHORIZING
20 DEBTOR TO PAY CERTAIN PRE-PETITION PROPERTY TAXES

21 Pacific Gas and Electric Company, the debtor and debtor in possession in the above-
22 captioned case (the "Debtor" or "PG&E"), respectfully submits this Memorandum of Points
23 and Authorities in Support of its Motion for Order Authorizing the Debtor to Pay Certain
24 Pre-Petition Property Taxes (the "Motion").

25 Pursuant to the Motion, PG&E requests authority to pay certain real property secured
26 taxes assessed by the counties listed on Exhibit A to the Declaration of Charles M. Marre
27 filed concurrently herewith (the "Marre Declaration"), with respect to periods prior to April
28 6, 2001, the date of commencement of this Chapter 11 case, to the extent that the counties

MPA ISO MOT. FOR ORDER AUTHOR. DEBTOR TO PAY PRE-PETITION REAL PROP. TAXES

1 waive any penalties for late payment of such taxes. The Motion is made on the grounds that
2 the claims for such taxes are fully secured claims, the immediate payment of such claims
3 will reduce the estate's liability for late payment penalties and does not prejudice any other
4 creditors, and the failure to pay such claims would impose undue hardship on many of the
5 counties, which may depend on the taxes paid by PG&E to fund essential services.
6

7 **I.**

8 **INTRODUCTION**

9 PG&E is an investor-owned utility providing electric and gas services to millions of
10 California residents and businesses. Beginning approximately last summer, as a result of the
11 partial deregulation of the power industry, PG&E was forced to pay dramatically increased
12 wholesale prices for electricity, but has been prevented from passing these costs on to retail
13 customers, resulting in a staggering financial shortfall. In the face of the deterioration in
14 PG&E's financial condition and with little progress having been made toward a resolution of
15 the crisis, by early April 2001 PG&E determined that a Chapter 11 reorganization offered
16 the best prospects for protecting the interests of its customers, creditors, employees and
17 shareholders alike. Accordingly, on April 6, 2001, PG&E filed a voluntary petition under
18 Chapter 11 of the Bankruptcy Code. PG&E continues to manage and operate its business
19 and property as a debtor in possession pursuant to Sections 1107 and 1108 of the United
20 States Bankruptcy Code (11 U.S.C. §§1107, 1108). No trustee has been appointed.
21

22 **II.**

23 **DESCRIPTION OF THE PROPERTY TAXES**

24 PG&E owns real and personal property in 49 counties in California (each, a "County,"
25 and collectively, the "Counties"). Marre Declaration ¶2. Each year, the California State
26 Board of Equalization determines the aggregate value of all real and personal property
27 owned by PG&E in the state and allocates that value among each of the Counties. The
28 Counties accordingly bill PG&E for taxes based on these allocated property values. To the

1 extent the taxes are unpaid, each County obtains a statutory first priority lien against the real
2 property of PG&E located in such County.

3 The taxes owed to the Counties are paid in two installments, the first of which is due
4 on December 10, and the second of which is due on April 10 of the following year. Marre
5 Declaration ¶3. Following the filing of its Chapter 11 petition, PG&E divided the
6 installment due on April 10, 2001 into two portions—one based on the period from January
7 1 through April 5 (the “Pre-Petition Taxes), and the other based on the period from April 6
8 through June 30, 2001 (the “Post-Petition Taxes”). PG&E paid the Post-Petition Taxes but
9 has not paid the Pre-Petition Taxes, due to the general prohibition on the payment of pre-
10 petition debt by debtors under the Bankruptcy Code. The amounts of the Pre-Petition Taxes
11 owed to each of the Counties range from a low of \$14,690 to a high of \$7,329,994, and total
12 \$41,224,488, in the aggregate, exclusive of any penalties assessed for late payment. Marre
13 Declaration ¶4.

14 As a result of PG&E’s failure to pay the entire installments due on April 10, delinquent
15 penalties of 10% have attached to the Pre-Petition Taxes. (In addition, redemption fees and
16 monthly penalties may become payable with respect to the unpaid Pre-Petition Taxes.) The
17 local tax collector or auditor of each County has the authority to cancel the delinquent
18 penalties upon a determination that the failure to make a timely payment is due to reasonable
19 cause and circumstances beyond the taxpayer’s control, and occurred notwithstanding the
20 exercise of ordinary care in the absence of willful neglect.¹

21 As discussed more fully below, PG&E seeks this Court’s authorization to pay the Pre-
22 Petition Taxes to those Counties that waive the delinquent penalties, on the grounds that the
23 claims for such taxes are fully secured claims, the payment of such claims will reduce the
24 estate’s liability for such penalties and does not prejudice any other creditors, and the failure
25 to pay such claims would cause undue hardship on many of the Counties, which may depend
26

27 ¹The delinquent penalties also may be cancelled if the cancellation is ordered by a
28 local, state or federal court.

1 on the taxes to fund essential services.

2
3 **III.**
4 **ANALYSIS**

5
6 **A. The Claims for Pre-Petition Taxes Are Secured Claims.**

7 California Revenue and Tax Code ("Tax Code") Section 721 and Section 19 of Article
8 XIII of the California Constitution provide that the State Board of Equalization shall
9 annually assess real and personal property owned or used by companies transmitting or
10 selling gas or electricity and that "this property shall be subject to taxation to the same extent
11 and in the same manner as other property." Tax Code Section 755 provides that the State
12 Board of Equalization shall transmit to each county auditor an estimate of the value of state-
13 assessed property for the purpose of determining tax rates. Pursuant to Tax Code Section
14 2151, the board of supervisors for each county "shall fix the rates of county and district taxes
15 and shall levy the state, county, and district taxes as provided by law." Pursuant to
16 California Government Code Section 25202, the board of supervisors shall "levy taxes upon
17 the taxable property of the county for all county purposes."

18 Pursuant to Tax Code Section 2187, "[e]very tax on real property is a lien against the
19 property assessed." Further, pursuant to Tax Code Section 2189, "[a] tax on personal
20 property is a lien on any real property on the secured roll also belonging to the owner of the
21 personal property, if the personal property is located upon that real property on the lien date,
22 and if the fact of the lien is shown on the secured roll opposite the description of the real
23 property."

24 Pursuant to Tax Code Section 2192.1, taxes declared to be liens on real property "have
25 priority over all other liens on the property, regardless of the time of their creation." Since
26 the Pre-Petition Taxes are taxes on state-assessed real and personal property, levied by the
27 Counties pursuant to Tax Code 2151 and Government Code 25202, they constitute first
28 priority liens against the real property owned by PG&E to which they relate.

1 B. The Liens on the Real Property Attached Pre-Petition.

2 The real property liens securing the Pre-Petition Taxes attached prior to the Petition
3 Date, and therefore, the Counties to whom the Pre-Petition Taxes are owed are secured
4 creditors of the Debtor. Pursuant to Tax Code Section 2192, with certain exceptions not
5 applicable here, "all tax liens attach annually as of 12:01 a.m. on the first day of January
6 preceding the fiscal year for which the taxes are levied." The fiscal year for which the Pre-
7 Petition Taxes were levied spans the years 2000-2001. Accordingly, the Pre-Petition Taxes
8 became liens on the applicable real properties on January 1, 2000.

9
10 C. The Counties Are Fully Secured Creditors.

11 As set forth in the Marre Declaration, the real properties subject to the Pre-Petition
12 Taxes have an assessed value in excess of the amount of the Pre-Petition Taxes attributable
13 to such properties. Marre Declaration ¶5. Accordingly, the Counties are fully secured
14 creditors with respect to such Pre-Petition Taxes, and payment by PG&E of their claims will
15 not adversely affect any other creditors in this case.

16
17 D. Failure To Pay the Pre-Petition Taxes May Cause Undue Hardship on the
18 Counties.

19 Many of the Counties depend on the property taxes paid by PG&E to finance the
20 delivery of essential goods and services to its residents. The Counties' budgets assume the
21 timely receipt of the Pre-Petition Taxes, and the Counties may not have alternate sources of
22 funds to supplement those budgets in the event that the Pre-Petition Taxes are not paid. See
23 Marre Declaration ¶6. Failure to receive prompt payment of the Pre-Petition Taxes may
24 render certain of the Counties unable to provide such services, causing undue hardship on
25 the residents of such Counties. Although some of the Counties may have sufficient revenues
26 other than the Pre-Petition Taxes to weather the delay in payment caused by PG&E's
27 Chapter 11 case in the absence of this Court's granting of this Motion, PG&E seeks
28 authority to pay such Counties' claims as well, on the grounds that it would be inequitable to

1 pay some Counties and not others, and that such payments would be difficult to administer
2 on a County by County basis, particularly if a determination of the needs of the respective
3 Counties were a prerequisite to payment.
4

5 E. The Delinquent Penalties Imposed on Unpaid Pre-Petition Taxes May be Waived.

6 Pursuant to Tax Code Section 2618 (or Section 2705 for counties which have elected to
7 collect taxes on personal property in two equal installments), the second installment of taxes,
8 "if unpaid, is delinquent at 5 p.m., or the close of business, whichever is later, on April 10,
9 and thereafter a delinquent penalty of 10% attaches to it." Further, pursuant to Tax Code
10 Section 2636, where an installment of tax is partially paid, "[t]he difference between the
11 amount paid by the taxpayer and the amount due shall be treated as a delinquent tax in the
12 same manner as any other delinquent tax." As set forth above, only the Post-Petition Taxes
13 were paid on April 10 and the Pre-Petition Taxes are currently unpaid. Accordingly,
14 delinquent penalties of 10% have attached to the Pre-Petition Taxes.

15 Pursuant to Tax Code Section 4985.2, the tax collector or auditor may cancel "[a]ny
16 penalty, costs, or other charges resulting from tax delinquency" upon a finding that "[f]ailure
17 to make a timely payment is due to reasonable cause and circumstances beyond the
18 taxpayer's control, and occurred notwithstanding the exercise of ordinary care in the absence
19 of willful neglect, provided the principal payment for the proper amount of the tax due is
20 made no later than June 30 of the fourth fiscal year following the fiscal year in which the tax
21 became delinquent."² Because PG&E's failure to make timely payment of the Pre-Petition
22 Taxes was due to the general prohibition on the payment of pre-petition debt by debtors
23 under the Bankruptcy Code, reasonable cause exists for the tax collector or auditor for each
24 County to cancel the delinquency penalties.
25

26 _____
27 ²Pursuant to Tax Code Section 4985.2, the tax collector or auditor also may cancel a
28 tax delinquency penalty upon a finding that the cancellation was ordered by a local, state or
federal court.

1 F. This Court Has the Authority To Authorize Payment of the Pre-Petition Taxes
2 under Section 105 of the Bankruptcy Code.

3 Pursuant to Section 105(a) of the Bankruptcy Code, bankruptcy courts are granted
4 broad discretion and authority to enforce the provisions of the Bankruptcy Code, either
5 under specific statutory provisions or under equitable common law principles. The
6 bankruptcy court's authority to permit payment of pre-petition debt, when such payment is
7 needed to facilitate the rehabilitation of the debtor, is commonly referred to as the "doctrine
8 of necessity" or the "necessity of payment" rule. See In re Ionosphere Clubs, Inc., 98 B.R.
9 174, 175-176 (Bankr. S.D.N.Y. 1989). Under this doctrine, a bankruptcy court may exercise
10 its equitable powers to authorize a debtor to pay certain prepetition claims, even though such
11 payment is not explicitly authorized under the Bankruptcy Code. See In re Columbia Gas
12 Sys., Inc., 136 B.R. 930, 939 (Bankr. D. Del. 1992) (citing In re Lehigh & New England Ry.
13 Co., 657 F.2d 570, 581 (3d Cir. 1981).

14 In this case, application of the necessity doctrine would aid in PG&E's reorganization
15 process, by allowing PG&E to avoid the post-petition accrual of interest and penalties on the
16 Pre-Petition Taxes. In addition, it would enable PG&E to avoid the potential of multiple
17 actions by Counties seeking relief from stay for nonpayment of the Pre-Petition Taxes based
18 on the financial hardship caused to such Counties by such nonpayment. Further, no useful
19 purpose would be served by denying authority to make such payment, because ultimately
20 these fully secured claims would be paid pursuant to a plan of reorganization in this
21 Chapter 11 case.

22
23 **IV.**

24 **CONCLUSION**

25 For all the foregoing reasons, PG&E respectfully requests that the Court: (1) find and
26 determine that notice of the Motion, and notice and opportunity to be heard at the hearing
27 were adequate and appropriate in the particular circumstances of the Debtor's bankruptcy
28 case; (2) enter its order granting the Motion in its entirety, and authorize PG&E to pay the

1 Pre-Petition Taxes to those Counties that waive the delinquent penalties with respect thereto;
2 and (3) grant such other and further relief as the Court deems just and proper under the
3 circumstances.

4
5 DATED: April 26, 2001

6 Respectfully,

7 HOWARD, RICE, NEMEROVSKI, CANADY,
8 FALK & RABKIN
9 A Professional Corporation

10 By: Janet Nexon
11 JANET A. NEXON

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