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UNITED STATES BANKRUPTCY COURT

NORTHERN DISTRICT OF CALIFORNIA

SAN FRANCISCO DIVISION

In re PACIFIC GAS AND ELECTRIC COMPANY, a California corporation, Debtor. Federal I.D. No. 94-0742640	No. 01-30923 DM Chapter 11 Case Date: May 18, 2001 Time: 10:00 a.m. Place: 235 Pine St., 22nd Floor San Francisco, California

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MEMORANDUM OF POINTS AND AUTHORITIES IN SUPPORT OF DEBTOR'S MOTION FOR ORDER VACATING THE APPOINTMENT BY THE UNITED STATES TRUSTEE OF THE OFFICIAL COMMITTEE OF RATEPAYERS

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INTRODUCTION

Pacific Gas and Electric Company, the debtor and debtor in possession in the above-captioned Chapter 11 case (the "Debtor" or "PG&E"), submits this Memorandum of Points and Authorities In Support of Debtor's Motion For Order Vacating the Appointment by the United States Trustee of the Official Committee of Ratepayers (the "Motion"). The Motion is brought pursuant to Rules 2020 and 9014 of the Federal Rules of Bankruptcy Procedure (the "Bankruptcy Rules") to contest the appointment by the United States Trustee ("UST") on May 4, 2001 of the Official Committee of Ratepayers (the "Ratepayers' Committee"). PG&E by the Motion asks the Court to vacate the UST's appointment of the Ratepayers' Committee on the ground that such appointment is beyond the committee appointment authority conferred on the UST under the Bankruptcy Code.

In a nutshell, the UST's appointment of the Ratepayers' Committee was purportedly made pursuant to Section 1102(a)(1) of the United States Bankruptcy Code, 11 U.S.C. §1102(a)(1).[1] However, that provision only authorizes the UST to appoint committees of creditors or of equity security holders and does not authorize the UST to appoint additional committees to represent other interests.[2] The organizations and individuals appointed to the Ratepayers' Committee -- and the ratepayers whose interests they supposedly represent -- are neither creditors nor equity security holders and are therefore not eligible for appointment to a committee by the UST under Section 1102(a)(1). Thus, the UST's appointment of the Ratepayers' Committee was not authorized by the Bankruptcy Code and constitutes an abuse of discretion by the UST. To remedy the UST's abuse of discretion, this Court should vacate the May 4, 2001 appointment.

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[1]Unless otherwise expressly stated, all "Section" references and citations in this brief are to the United States Bankruptcy Code (title 11 of the United States Code).

[2]Section 1102(a)(1) provides in pertinent part:

"[A]s soon as practicable after the order for relief under chapter 11 of this title, the United States trustee shall appoint a committee of creditors holding unsecured claims and may appoint additional committees of creditors or of equity security holders as the United States trustee deems appropriate." (Emphasis added.)

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GENERAL BACKGROUND

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

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APPOINTMENT OF COMMITTEES IN THIS CASE

Pursuant to Section 1102(a)(1), the UST was required to appoint a committee of creditors holding unsecured claims as soon as practicable after the April 6 entry of the order for relief in this case. On April 12, 2001, the UST discharged this responsibility by appointing a committee of unsecured creditors consisting of 11 members.

Section 1102(a)(1) also authorizes the UST to appoint additional committees of creditors or of equity security holders as the UST deems appropriate. On May 4, 2001, expressly relying on the authority granted it by Section 1102(a)(1), the UST appointed the Ratepayers' Committee in a pleading entitled "Appointment of Official Committee of Ratepayers" (the "Appointment"). Pursuant to the Appointment, the Ratepayers' Committee consists of nine members, all of whom are (or expressly represent) one type or another of a private special interest group or lobbying organization (collectively, the "Special Interest Groups"). More specifically, the Ratepayers' Committee consists of a different named employee from seven Special Interest Groups (the California School Boards

Association, the California Farm Bureau Federation, the California Dairy Institute, the Consumers Union, the California Restaurant Association, The Utility Reform Network, and the California Manufacturers & Technology Association), and two outside counsel on behalf of three additional Special Interest Groups (Carl Oshiro on behalf of the California Small Business Association and the California Small Business Roundtable, and David Byers on behalf of the California City-County Streetlight Association). To the best of PG&E's knowledge, with one exception,[3] none of these Special Interest Groups are creditors of or equity interest holders in PG&E.

ARGUMENT

A. The Actions Of The UST Under Section 1102 Are Subject To Judicial Review Under The Abuse Of Discretion Standard.

As a general matter, the power to appoint and remove members of official committees resides with the UST under Section 1102. Smith v. Wheeler Tech., Inc. (In re Wheeler Tech., Inc.), 139 B.R. 235, 239 (B.A.P. 9th Cir. 1992). However, the actions of the UST under Section 1102 are not immune from judicial review. Rather, under the clear majority view, the UST's appointments under Section 1102 are subject to judicial review under an abuse of discretion standard. See Bodenstein v. Lentz (In re Mercury Fin. Co.), 240 B.R. 270, 277 (N.D. Ill. 1999); In re Value Merchants, Inc., 202 B.R. 280, 287 (E.D. Wis. 1996); Masters, Mates & Pilots Plans v. Lykes Bros. S.S. Co., Inc. (In re Lykes Bros. S.S. Co., Inc.), 200 B.R. 933, 939 (M.D. Fla. 1996) ("Lykes"); In re Rick Pierce, 237 B.R. 748, 752 (Bankr. E.D. Cal. 1999); Matter of Columbia Gas Sys., Inc., 133 B.R. 174, 175 (Bankr. D. Del. 1991).

According to the minority position, the 1986 amendments to Section 1102 – which shifted responsibility for committee appointments from Bankruptcy Courts to the

[3]The Utility Reform Network may have a limited claim for compensation pertaining to its appearance in proceedings before the California Public Utilities Commission.

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UST and which deleted former Section 1102(c) expressly authorizing Bankruptcy Courts to change the membership or size of a committee – somehow abrogated the Bankruptcy Court's authority to review the UST's decisions regarding committee membership, thus leaving the UST with sole, unreviewable discretion. See, e.g., In re Dow Corning Corp., 212 B.R. 258, 262 (E.D. Mich. 1997); In re New Life Fellowship, Inc., 202 B.R. 994, 997 (Bankr. W.D. Okla. 1996); In re Victory Markets, Inc., 196 B.R. 1, 4 (Bankr. N.D.N.Y. 1995); In re Hills Stores Co., 137 B.R. 4, 8 (Bankr. S.D.N.Y. 1992).[4]

Not surprisingly, the majority (and better-reasoned) view rejects the notion that the UST can ignore the express statutory standards set forth in Section 1102 without the possibility of corrective judicial review. As stated in one fully-reasoned decision by a California-sited Bankruptcy Court following the majority view:

> "[T]he court does not believe that Congress intended to grant the UST wholly unfettered discretion in appointing committee members. Appointments by the UST must, logically, be reviewable in some manner, by some forum. Nothing in the logic or history of the Code indicates that by removing section 1102(c), Congress intended to give the UST unfettered and unreviewable discretion in this regard. The question is not whether the UST's appointments are reviewable, but rather under what standard and by what procedure." (Pierce, 237 B.R. at 753)

Cases espousing the majority view have gone on to conclude that Section 105(a), which authorizes the Bankruptcy Court to "issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title," supplies ample authorization for Bankruptcy Courts to review the UST's committee appointment decisions for an abuse of discretion:

> "The court may not invoke §105(a) to create substantive rights that are

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[4]The Ninth Circuit Bankruptcy Appellate Panel's decision Smith v. Wheeler Tech., Inc. (In re Wheeler Technology, Inc.), 139 B.R. 235, 238 (B.A.P. 9th Cir. 1992), has on occasion been mis-cited in support of the minority position. However, the question of the court's authority to review the UST's committee appointments was not before the Wheeler court. Rather, the question in Wheeler was whether a Bankruptcy Court could remove a creditor from the creditors' committee as a sanction for violating the automatic stay. In Wheeler, no decision of the UST was being challenged, and the Wheeler decision simply is inapposite to the present Motion. For a thoughtful analysis of Wheeler and why Wheeler is consistent with the majority view recognizing the availability of judicial review of the UST's committee appointments under Section 1102, see In re Rick Pierce, 237 B.R. 748, 754-55 (Bankr. E.D. Cal. 1999).

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> not provided by the Code or to constitute a roving commission to do equity . . . . But §105(a) may be invoked to assure that the United States trustee does not act arbitrarily and capriciously in performing his administrative tasks mandated by the Code." (Id. at 754 (citing In re First RepublicBank Corp., 95 B.R. 58, 60 (Bankr. N.D. Tex. 1988)) (emphasis added))

Thus, the law applicable to the subject Appointment is that the UST's action under Section 1102 is reviewable by this Court for abuse of discretion. This view is consistent with the strong presumption that Congress intends judicial review of administrative action and that, absent clear and convincing evidence of contrary legislative intent, the courts should not restrict access to judicial review. Lykes, 200 B.R. at 939 (citing Bowen v. Michigan Acad. of Family, 476 U.S. 667, 670 (1986)).

Turning to what constitutes an abuse of discretion, it will generally be found if a decision-maker acted in an "irrational, arbitrary, or capricious manner." Pierce, 237 B.R. at 754. As will be shown below, by appointing the Ratepayers' Committee, comprised exclusively of persons and organizations who are neither creditors nor equity holders, the UST has acted wholly outside of the authority granted to it under the Code, and the Appointment is therefore by definition arbitrary and irrational and necessarily constitutes an abuse of discretion. Thus, this Court has the authority under Section 105(a) to issue any order necessary to rectify the situation, including the authority to vacate the Appointment.

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B. The Special Interest Groups Are Not Eligible For Appointment To A Section 1102 Committee, And Therefore The UST's Appointment Is Beyond Its Authority.

Under the express language of Section 1102(a)(1), the UST is only authorized to appoint committees of creditors or of equity security holders. The power to determine the requisite eligibility criteria for any official committee and its members under Section 1102 has been fully exercised by Congress and is not vested in the UST:

> "Congress' grant of power to the Trustee in §1102 to appoint committees contains an implicit limitation: the Trustee has the discretion to appoint only eligible individuals." (In re Mercury Fin. Co., 240 B.R. at 277)

The issue of appointments of committees under Section 1102 was addressed in the context of a utility's Chapter 11 case in In re Eastern Maine Elec. Coop., Inc., 121 B.R. 917 (Bankr. D. Me. 1990) (hereinafter Maine Electric). In that case, which involved the Chapter 11 reorganization of a customer-owned electrical utility cooperative, the UST had not appointed a Section 1102 committee to represent the interests of the members of the cooperative. The Maine Public Advocate, a public body with a state statutory duty to intervene on behalf of the public in any proceeding affecting utility customers, requested the court to order the UST to appoint a committee consisting of members of the cooperative, who were also among the utility's customers. The court noted that its ability to order the UST to appoint an official committee of the cooperative's members was subject to the express limitations in Section 1102:

> "Unless the interests of the cooperative's membership can be characterized as those of creditors or of equity security holders, 1102(a)(2) grants no authority to establish a committee." (Id. at 927)

In determining whether the appointment of a committee of members was possible under Section 1102(a), the court properly focused on whether the members were equity security holders or creditors of the debtor. Id. at 931-32. Further, the court indicated that had it focused exclusively on the members' status as customers, the request for appointment of a Section 1102 Committee could have been rejected out of hand. Id. at 930. This tracks the plain language of Section 1102(a), viz., that customers (here ratepayers) are obviously neither creditors nor equity security holders. Although Maine Electric concerned a request of the court to order an appointment of a committee pursuant to Section 1102(a)(2) as opposed to a request for judicial review of an appointment by the UST, the court's comments with respect to eligibility are equally applicable to the authority of the UST under Section 1102(a)(1).

Under both the express language of Section 1102(a)(1) and applicable case law, then, it is clear that the UST is authorized to appoint only committees of eligible interested parties, i.e., creditors holding unsecured claims or equity security holders. It is no accident that Congress limited the types of (and qualification for membership on) official committees

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to these two key categories in light of the far-ranging rights and privileges afforded to official committees in Chapter 11 cases.

More specifically, the powers and duties of official committees appointed by the UST under Section 1102 are set forth in Section 1103. Pursuant to Section 1103(a), an official committee may, with the Bankruptcy Court's approval, employ one or more attorneys, accountants or other professionals at the expense of the estate to assist it with its duties. In addition, Section 1103(c) authorizes an official committee to be heard on virtually all significant issues in the case and perform a wide range of important functions, including (1) consulting with the debtor in possession concerning the administration of the estate; (2) investigating the acts, conduct, assets, liabilities and financial condition of the debtor, its operations, and the desirability of the continuance of the debtor's business, and any other matters relevant to the case or the formulation of a plan; (3) negotiating and advising the committee's constituency about any reorganization plan, and collect and file acceptances or rejections of a plan; and (4) requesting appointment of a trustee or examiner under Section 1104. See generally 2 Collier on Bankruptcy §105.01 at 105-6 (15th ed. rev. 2000). Finally, Section 503(b)(3)(F) allows for the reimbursement of actual, necessary expenses incurred by a member of an official committee in the performance of its duties.

There should be no dispute that PG&E's ratepayers – the customers to whom PG&E distributes natural gas and/or electricity – are not creditors or equity security holders of PG&E in their capacities as ratepayers.[5] That alone is dispositive of the present Motion, since there is no basis in law or logic for appointing a debtor's customers, as distinct from a debtor's creditors and equity interest holders, to an official committee under Section 1102. Accordingly, even if the UST had appointed actual ratepayers to the Ratepayers' Committee, the appointment would be beyond the UST's statutory authority and therefore should be

[5]While some customers may be minor creditors of PG&E to the extent they have a security deposit posted with PG&E, their interest as creditors in this limited capacity does not need protection or require any special participation in light of PG&E having obtained an order from the Bankruptcy Court shortly after the commencement of this case, allowing PG&E to deal with and refund all regular pre-petition customer deposits in the ordinary course of business as conducted prior to the Chapter 11 filing.

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vacated.

But here, in fact, the Ratepayers' Committee is a giant step further down the extra-statutory, ultra vires path. As detailed in the Appointment of Committees section of this brief, the UST in fact appointed organizations that are Special Interest Groups to serve on the Ratepayers Committee, not because they are necessarily PG&E ratepayers themselves or are motivated by any capacity as a PG&E ratepayer, but presumably on the theory that these Special Interest Groups represent the interests of certain ratepayers. Thus, for example, presumably the California School Boards Association is intended to represent the interests of various school district ratepayers, the California Restaurant Association is intended to represent the interests of restaurant ratepayers, and so on. Yet none of the Special Interest Groups can claim a mandate to represent the interests of PG&E ratepayers generally. Rather, the Special Interest Groups represent the narrow interests of particular industries, or are groups having particular policy objectives. And at least some of the Special Interest Groups appointed to the Ratepayers' Committee, including, most notably, the Consumers Union and The Utility Reform Network, are known as well-organized lobbyists and political operatives.

Thus, even putting aside the fact that ratepayers themselves cannot properly be appointed to an official committee in their capacity as ratepayers, and assuming arguendo that an official committee of ratepayers could be appointed, the attenuated "representative" status of the appointed members of the Ratepayers' Committee is in any event objectionable. While the courts have recognized that a person with a fiduciary relationship with a creditor or equity interest holder can represent the interest of that creditor or equity interest holder on an official committee, courts have also made reasonably clear that there are limits on "representative" members of an official committee. Thus, courts generally have approved an attorney serving on an official committee as the representative of its creditor or equity interest holder client, or an indenture trustee as the representative of the holders of bonds issued under the applicable indenture, or even a union as the representative of bargaining unit employees, but have generally not approved more attenuated "representative" members

where there is not a fiduciary or other legal relationship between the representative member and the underlying represented principal(s). See generally In re Value Merchants, Inc., 202 B.R. at 284 (indenture trustee representative permissible); In re Northeast Dairy Coop. Fed'n, Inc., 59 B.R. 531, 533 (Bankr. N.D.N.Y. 1986) (union representative permissible); In re M.H. Corp., 30 B.R. 266, 267 (Bankr. S.D. Ohio 1983) (attorney representative permissible). Thus, under both the letter and spirit of the applicable case law, the Special Interest Groups simply do not qualify as proper representatives for the members of any official committee, let alone an impermissible committee of ratepayers.

In the end, there is considerable wisdom in Congress's decision to limit the membership of official committees under Section 1102 to creditors and equity interest holders, and to exclude a Chapter 11 debtor's customers and other interest groups from committee service. As already noted, an official committee under Section 1102 has considerable rights and privileges, including the power to utilize substantial judicial and estate resources. The important seats at the Chapter 11 table afforded to official committees are not to be taken lightly or to be passed around widely, and it is no accident that Congress limited these seats to creditors (and, in the UST's discretion, to equity interest holders), since a fair resolution of creditors' claims lies at the heart of the Chapter 11 process.

Indeed, little imagination or conjecture is required to appreciate the distractions, drain on resources and other problems that would result from affording the Ratepayers' Committee the status of an official committee under Section 1102. Those members that are "merely" special interest associations do not have any of the normal reorganization interests or incentives of creditors or equity interest holders. And at least some of the Special Interest Groups that have been appointed to the Ratepayers' Committee not only have well-known political and policy agendas that have nothing to do with the reorganization principles of the Bankruptcy Code, but also have a demonstrated history of aggressive lobbying and litigation. Turned loose in the Chapter 11 context on the nickel of the bankruptcy estate, these proclivities could substantially retard the progress of this case and seriously prejudice its outcome. Simply stated, while the Special Interest Groups have every right to participate

in any political process they wish and, as discussed further in Part C below, to seek to participate in this case on specific issues as to which they may be interested parties, they do not have the right to constitute an official committee under Section 1102. Put another way, while PG&E appreciates the concerns of the Special Interest Groups and the ratepayers, the Chapter 11 bankruptcy forum is not the State Capitol, and the Chapter 11 reorganization process should not be permitted to become a principally political exercise where the customers of the debtor are given a voice equal to that of the creditors.

In sum, because neither the Special Interest Groups appointed to the Ratepayers' Committee nor the ratepayers they supposedly represent are creditors or equity security holders of PG&E, the UST's Appointment of the Ratepayers' Committee plainly was outside its appointment authority under Section 1102. This Court therefore should vacate the Appointment pursuant to its equitable powers under Section 105(a).

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C. Other More Appropriate Means Of Participation Are Available To Represent The Interests Of Ratepayers In The Case.

Although the Special Interest Groups and PG&E's ratepayers are not eligible for appointment by the UST to an official committee under Section 1102, the Bankruptcy Code offers other (and more appropriate) means by which ratepayers may be represented and heard in this case. Most prominently, ratepayers or knowledgeable representatives of ratepayers could seek to intervene in the case pursuant to Bankruptcy Rule 2018. Two decisions involving bankruptcies of public utilities are highly instructive on this point.

In In re Public Serv. Co., 88 B.R. 546, 556-57 (Bankr. D.N.H. 1988), in which the debtor was the state's main electrical utility, the Attorney General for the State of New Hampshire was granted full party in interest and intervenor status to represent the interests of the state's regulatory agencies in the Chapter 11 case. In addition, the Office of the Consumer Advocate (an independent office created by the Legislature for the purpose of representing the interests of residential utility consumers) and the Business and Industry Association of New Hampshire were granted limited rights of intervention under Bankruptcy

Rule 2018(a) to represent, respectively, the interests of New Hampshire's residential and business users of electricity.

Similarly, in Maine Electric, 121 B.R. at 922, the court affirmed an order that had granted the Maine Public Utilities Commission ("MPUC") and the Maine Public Advocate ("MPA") limited rights of intervention in the bankruptcy case. The order granting intervenor status stipulated that as intervenors they would have no rights of appeal and that their costs of participation would not be considered expenses of administration. In that case, both the MPUC and MPA had a statutory basis for their participation in the case. The MPUC had state law regulatory authority over electric utilities. The MPA had statutory duties that included intervening on behalf of the consuming public in any court proceedings in which the subject matter of the action affected utility customers.

Just as in Public Service Co. and Maine Electric, here intervention pursuant to Bankruptcy Rule 2018 is a far more appropriate means for participation of PG&E's ratepayers than participation through an official committee appointed under Section 1102.[6] Bankruptcy Rule 2018 affords the Bankruptcy Court the flexibility and discretion to determine whether intervention as a party in interest in the entire case is warranted, and, if not, to still allow intervention on any specific matter as to which the Bankruptcy Court concludes the proposed intervenor is an interested party. 9 Collier on Bankruptcy §2018.04[2] at 2018-6 (15th ed. rev. 2000). Thus, the Bankruptcy Court has wide latitude to define the manner in which an intervenor may participate in a case or proceeding and may specifically design the terms of intervention which are appropriate in the circumstances and which will not cause undue delay and expense.

Sections 1102 and 1103, by contrast, provide a mechanism for the orderly representation of the interests of creditors and equity security holders, persons having direct financial interests in the outcome of a reorganization and the payment of a Chapter 11

[6]Of course, the burden would be on any person or group requesting intervention to make the necessary showing for intervention.

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debtor's claims. The interests of PG&E's ratepayers in the case are of a different kind, relating to the impact of a reorganization of PG&E on electricity rates as opposed to the resolution of any claims against PG&E. The functions that official committees are authorized to perform under Section 1103 are not designed with the protection of a debtor's customers in mind. For example, the ability to investigate the acts, conduct, assets, liabilities and financial condition of the debtor and the ability to appoint a trustee, clearly relate to the preservation of assets available for satisfaction of claims and interests in the debtor's estate. In addition, the duty of an official committee under Section 1103(c)(3) to collect and file acceptances or rejections of a plan is also clearly intended only for those entities who are required to approve a reorganization plan, i.e., holders of claims or interests.

The establishment of an additional official committee under Section 1102 to represent the interests of ratepayers, and the consequent grant of the powers of Section 1103 to such a committee, has the very real and undesirable potential to overburden the reorganization process, adding to delay and increasing the costs for the Debtor and the estate's creditors, and thwarting the goal of a speedy and efficient reorganization.[7] By contrast, the flexibility afforded this Court and all parties in interest by requiring ratepayers to resort to the intervention procedure under Bankruptcy Rule 2018 is far preferable, and fully protects ratepayers' right to seek to be heard on any one or more issues in this case.

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[7]These objectives and the importance of preserving them were discussed in the context of applications for party in interest and intervenor status in In re Ionosphere Clubs, Inc., 101 B.R. 844, 850 (Bankr. S.D.N.Y. 1989), and In re Public Serv. Co., 88 B.R. 546, 553-54 (Bankr. D.N.H. 1988). In Ionosphere, the court, in denying a request for party in interest status to the Consumers Union (ironically, one of the Special Interest Groups appointed to the Ratepayers' Committee in this case), stated that "granting party in interest status to a non-creditor would saddle this estate with the burden of paying C[onsumers] U[nion]'s attorneys fees, costs and expenses. Such an additional burden is unwarranted in a case which already has spiraling professional expenses." Id. at 851.

CONCLUSION

For each and all of the foregoing reasons, PG&E respectfully requests that this Court make and enter an order vacating the United States Trustee's appointment of an Official Committee of Ratepayers on May 4, 2001.

DATED: May 9, 2001

Respectfully,

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