

1 LEWIS KRUGER (*Pro Hac Vice* Admission Pending)  
ALAN Z. YUDKOWSKY (State Bar No. 194994)  
2 PETER JAZAYERI (State Bar No. 199626)  
STROOCK & STROOCK & LAVAN LLP  
3 2029 Century Park East, Suite 1800  
Los Angeles, California 90067-3086  
4 Telephone: (310) 556-5800  
Facsimile: (310) 556-5959

5 BRUCE BENNETT (State Bar No. 105430)  
6 MICHAEL A. MORRIS (State Bar No. 89842)  
HENNIGAN, BENNETT & DORMAN  
7 601 South Figueroa Street, Suite 3300  
Los Angeles, California 90017  
8 Telephone: (213) 694-1200  
Facsimile: (213) 694-1234

9 Attorneys for Party in Interest  
10 SEMPRA ENERGY TRADING CORP.

11  
12  
13 UNITED STATES BANKRUPTCY COURT  
14 NORTHERN DISTRICT OF CALIFORNIA  
15 SAN FRANCISCO DIVISION

16 In re )  
17 PACIFIC GAS AND ELECTRIC COMPANY, )  
a California corporation, )  
18 Debtor. )

19  
20 Federal I.D. Number 94-0742640  
21  
22

Case No. 01-30923 DM

Chapter 11

**NOTICE OF MOTION AND MO-  
TION OF SEMPRA ENERGY TRAD-  
ING CORP. FOR RELIEF FROM  
STAY AND FOR ADEQUATE PRO-  
TECTION [11 U.S.C. § 362(d)(1), LO-  
CAL BANKRUPTCY RULES 4000-1  
AND 9013-1]; MEMORANDUM OF  
POINTS AND AUTHORITIES IN  
SUPPORT THEREOF**

**[Declaration of Stefanie Katz, and Re-  
quest for Judicial Notice concurrently  
filed herewith]**

Hearing:

DATE: June 20, 2001

TIME: 1:30 p.m.

CTRM: 235 Pine Street, 22<sup>nd</sup> Floor  
San Francisco, California

JUDGE: Hon. Dennis Montali

50-275/323  
Aool  
of Add: Kids Age Mail Center

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SIROCK & SIROCK & LAVAN LLP  
ATTORNEYS AT LAW  
3029 CANTOR PARK EAST, SUITE 1800  
LOS ANGELES, CALIFORNIA 90067-8086  
PHONE (310) 576-5800

**TABLE OF AUTHORITIES**

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SIRCOCK & SIRCOCK & LAVAN LLP  
 ATTORNEYS AT LAW  
 2029 CANTERA PARK EAST, SUITE 1800  
 LOS ANGELES, CALIFORNIA 90067-4086  
 PHOENIX (480) 556-5800

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## I. NOTICE OF MOTION

PLEASE TAKE NOTICE that on June 20, 2001 at 1:30 p.m., or as soon thereafter as counsel may be heard, in the courtroom of the Honorable Dennis Montali, located at 235 Pine Street, 22nd Floor, San Francisco, California, a hearing will be held on this "Notice Of Motion And Motion Of Sempra Energy Trading Corp. For Relief From Stay and for Adequate Protection" (the "Motion"), filed by Sempra Energy Trading Corp. ("SET"). The Motion is based on these moving papers, the memorandum of points and authorities included herein, the Declaration of Stefanie Katz, and the Request for Judicial Notice filed concurrently herewith and such other and further evidence and memoranda as may be submitted prior to the hearing.

## II. PRELIMINARY STATEMENT

By this motion, SET seeks two forms of relief. First, SET requests an order of this Court lifting the automatic stay to permit SET to continue an alternative dispute resolution process that was commenced by the Debtor prepetition, including the initiation of an arbitration case, to resolve contractual disputes that arose between SET and the Debtor prior to the filing of this chapter 11 case. The dispute between SET and the Debtor arises from the Debtor's claims that SET remains obligated to deliver natural gas to Debtor pursuant to transactions entered into under a Gas Transmission and Service Agreement (the "GTSA"). SET contends that it is no longer obligated to deliver natural gas to the Debtor because SET's obligations to do so were extinguished upon SET's exercise of its contractual rights of liquidation and setoff prior to the filing of this chapter 11 case. The GTSA specifically provides dispute resolution procedures, including arbitration, for all disputes "arising out of or relating to" the GTSA. Because the dispute between SET and the Debtor is a non-core matter and because SET and the Debtor contractually agreed to resolve disputes by arbitration, this Court should grant relief from the automatic stay to permit the resolution of this dispute. Moreover, even if the dispute between SET and the Debtor were a core matter, given the nature of the dispute and the contractual agreement to resolve disputes through arbitration, this Court should grant relief from the automatic stay to permit the disputes to be resolved through arbitration.

Second, SET seeks an order from this Court granting SET adequate protection of its interest in gas delivered by it that is not otherwise covered by the stipulation noted below. Citing to the

1 GTSA and its related schedules, the Debtor contends that SET was required to make certain net de-  
2 liveries of natural gas prior to June 2001 (the "Pre-June 2001 Gas") that was previously lent to SET,  
3 and that SET is subject to penalties for each day it fails to deliver such gas. The applicable tariffs  
4 provide for a 30-day cure period for delivery of such gas and SET has, within each applicable cure  
5 period, offered to deliver such gas to the Debtor, reserving its contention that its obligation to deliver  
6 any of the natural gas to the Debtor was extinguished prior to the filing of this chapter 11 case pursu-  
7 ant to its contractual rights of liquidation and setoff under an International Swap Dealers Association  
8 Agreement ("ISDA") and a Master Gas Purchase and Sale Agreement ("Master Gas Agreement").  
9 This dispute notwithstanding, because SET is willing to make the deliveries demanded by the Debtor  
10 and because the applicable tariffs require the Debtor to accept such gas, SET is entitled to adequate  
11 protection for its interest in such gas.<sup>1</sup> SET respectfully requests that this Court grant it adequate  
12 protection pursuant to section 363 of the Bankruptcy Code in the form of a substitute lien on property  
13 satisfactory to SET or such other form of adequate protection authorized by Bankruptcy Code section  
14 361.

15 As will be shown below, SET seeks eminently reasonable relief. First, it is well-settled  
16 that the automatic stay should be lifted in order to allow for the arbitration of a non-core  
17 contractual dispute. Second, SET has offered to deliver the Pre-June 2001 Gas demanded by the  
18 Debtor and the applicable tariff mandates that the Debtor accept delivery of this gas. Accordingly,  
19 adequate protection is appropriate under the circumstances and, therefore, the instant motion  
20 should be granted.

### 21 III. STATEMENT OF RELEVANT FACTS

22 SET is a wholesale energy trading company engaged in marketing and trading physical and  
23 financial energy products, including natural gas, power, crude oil and associated commodities and  
24

25 <sup>1</sup> SET and the Debtor have entered into a stipulation whereby SET will deliver the natural  
26 gas demanded by the Debtor on a going forward basis commencing in June 2001 (the  
27 "Stipulation"). Request for Judicial Notice ¶ 10, Ex. J. The Stipulation does not cover the Pre-  
28 June 2001 Gas that the Debtor contends SET was required to deliver. Accordingly, SET's request  
for adequate protection in this Motion relates only to the deliveries that it makes to the Debtor that  
are not otherwise covered by the Stipulation.

1 financially settled swaps thereon. Pacific Gas and Electric Company (the “Debtor”) and SET entered  
2 into a number of agreements long before the commencement of this Chapter 11 case.

3 **A. The Pre-Petition Agreements.**

4 The basis for the current dispute between the Debtor and SET arises out of five pre-petition  
5 agreements relating to the purchase, sale, and trading of natural gas and electrical power commodi-  
6 ties. In 1998, the parties entered into the first of these, the Master Gas Agreement, pursuant to which  
7 SET sold natural gas to the Debtor. Declaration of Stefanie Katz (“Katz Decl.”), ¶ 2; Ex. 1. Article  
8 11.1 of the Master Gas Agreement specified, *inter alia*, that a “Default” would occur if either party  
9 became “bankrupt or insolvent, however evidenced or be unable to pay its debts as they fall due.” *Id.*  
10 Ex. 1, at 12. In the event of such a default, Article 11.2 allowed the non-defaulting party to “cancel  
11 and liquidate [the Master Gas] Agreement” and to “set off all amounts which the Defaulting Party  
12 owes to it against any or all amounts which it owes to the Defaulting Party.” *Id.* Ex. 1, at 12-13.

13 At or about the same time, the parties also entered into the GTSA which allowed the parties  
14 to borrow and later return natural gas to each other at various times. *Id.* ¶ 3; Ex. 2. The GTSA is a  
15 standard form contract prepared by the Debtor. In the event that the parties find themselves in a  
16 situation where SET owes natural gas to the Debtor or the Debtor owes natural gas to SET, the  
17 GTSA purports to impose “imbalance” penalties pursuant to one of its related schedules, the G-BAL.  
18 *Id.* ¶ 4; Ex. 3. The G-BAL provides for a mandatory 30-day cure period, commencing from the end  
19 of the month in which the “underdelivery” or “overdelivery” occurred, during which the Debtor and  
20 SET are required to reach an agreement to make up such imbalance “in-kind” during a specified pe-  
21 riod and at a specified rate; that is, the Debtor and SET are to agree on a mutually convenient deliv-  
22 ery date and rate for the return of the gas loaned. *Id.* Ex. 3, at 12. If after the 30-day period, the  
23 Debtor and SET are unable to reach such an agreement, then the G-BAL purports to impose both a  
24 daily penalty and a penalty of 150% of the highest average published daily price for the underdeliv-  
25 ered gas not provided by SET or taken by the Debtor. *Id.* In the more than three years since the par-  
26 ties executed the GTSA and have operated under its related schedules, including the G-BAL, the  
27 Debtor *never once* has imposed underdelivery penalties on SET until now. Rather, in *every* instance,  
28 the parties have resolved their disputes by agreement. This is not surprising since the Debtor, in

1 some cases, prolonged the underdeliveries by requesting SET to defer its delivery to a later point in  
2 time. Katz Decl. ¶ 5.

3 The following year, in mid-1999, the parties entered into certain market participation agree-  
4 ments with both the California Independent System Operator Corporation and the California Power  
5 Exchange Corporation. Pursuant to these agreements, SET sold electrical energy to the Debtor in the  
6 California markets. Id. ¶ 6.

7 Then, in July 1999, the parties entered into the ISDA. Id. ¶ 7. The ISDA is an integrated  
8 agreement consisting of a Master Agreement, containing standard provisions, and a Schedule which  
9 contains standard elections and any specific changes or modifications agreed to by the parties. Id.;  
10 Ex. 6. In Part 1(b) of the Schedule, the Debtor and SET amended the Early Termination provisions  
11 to reference all “agreements for the purchase, sale or transfer of any commodity or any other com-  
12 modity trading transaction” thereby acknowledging that a default under any commodities transaction  
13 between the Debtor and SET (*e.g.*, purchases and sales of gas, electricity, etc.) would trigger a default  
14 under the ISDA. Id. Ex. 6 (ISDA Schedule) at 1. At the same time, the parties agreed, pursuant to  
15 the ISDA’s Early Termination provisions, that a party would be deemed to be in default if, *inter alia*,  
16 it (1) fails to pay or deliver; or (2) becomes “insolvent or is unable to pay its debts or fails or admits  
17 in writing its inability generally to pay its debts as they come due.” Id. (ISDA Master), Section 5(a),  
18 at 5-6. In the event of any such default, the ISDA Schedule broadened the parties’ rights (as provided  
19 for in the ISDA Master) by specifically granting the non-defaulting party the right to “set off all  
20 sums or obligations, whether matured or unmatured, owed by the Defaulting Party ... to the Non-  
21 defaulting Party against any sum or obligation, whether matured or unmatured ... owed by the Non-  
22 defaulting Party to the Defaulting Party ....” Id. (ISDA Schedule), Section 5(c), at 11. For purposes  
23 of this setoff “the Non-defaulting Party may (i) estimate in good faith any sum or obligation that is  
24 unascertained and set off in respect of that estimate, subject to accounting to the Defaulting Party  
25 when such sum or obligation is ascertained.” Id.

26 **B. The Debtor’s Default.**

27 In October 2000, the Debtor’s financial troubles began to surface in SEC filings by its parent  
28 company, PG&E Corporation (“PG&E Corp.”), and in the media. These financial troubles continued

1 to escalate and were regularly documented both in the press and in PG&E Corp.'s public filings.<sup>2</sup>  
2 These public disclosures culminated in the January 17, 2001 8-K filing, in which PG&E Corp. con-  
3 ceded that Standard & Poor's had reduced the long-termed corporate credit ratings of the Debtor  
4 from BBB- to CC to reflect "the heightened probability of the Debtor's 'imminent insolvency,'" that  
5 the "downgrade of [the Debtor's] ratings below investment grade constitutes an event of default un-  
6 der [the Debtor's] \$850 million revolving credit facility," that the Debtor was "not in a position to  
7 pay maturing or accelerated obligations, including accelerated payments under gas supply contracts,"  
8 and that the Debtor was not "in a position to pay the ISO, PX and the QFs, the massive amounts due  
9 for [the Debtor's] power purchases above the amount included in rates for power purchase costs."  
10 Request for Judicial Notice, ¶ 9, Ex. I. In short, PG&E Corp. disclosed that the Debtor effectively  
11  
12

13 <sup>2</sup> For example, in its October 25, 2000 8-K filing, PG&E Corp. warned that the "amount of  
14 [the Debtor's] costs that exceed revenues collected from frozen rates" as of September 30, 2000,  
15 "was approximately \$2.9 billion." In its November 1, 2000 10-Q Quarterly Report, PG&E Corp.  
16 lamented that "if regulatory or judicial relief is not forthcoming, and if [the Debtor] determines  
17 that its uncollected wholesale power purchase costs are not probable of recovery, then [the Debtor]  
18 would be required to write off the unrecoverable portion as a charge against earnings." See also,  
19 Steve Johnson, *Northern California Utility Plans Steady Rate Increases*, San Jose Mercury News,  
20 November 23, 2000 ("urged the Public Utilities Commission to quickly approve the plan [to allow  
21 increases in capped electricity rates] claiming it soon could be 'forced into bankruptcy' other-  
22 wise."); December 18, 2000 8-K filed by PG&E Corp. ("Moody's Investor Services, Inc., a princi-  
23 pal credit rating agency, has placed the securities of [the Debtor] under review for possible down-  
24 grade" and "Standard & Poor's has placed the securities of PG&E Corporation, [the Debtor], and  
25 related entities on 'credit watch' with negative implications."); December 22, 2000 8-K filed by  
26 PG&E Corp. (PG&E Corp. "warned during a public conference call with the financial community  
27 that it must see dramatic action by California decision makers within twenty-four to forty-eight  
28 hours in order to prevent a downgrade of [the Debtor's] credit rating to a speculative grade to re-  
reflect the likelihood of imminent default."); Chris Reed, *Power Crunch: Events of the Past Week*,  
Orange County Register, December 24, 2000 (PG&E warned that it "could go bankrupt without  
rate hikes of as much as 30 percent."); January 2, 2001 8-K filed by PG&E Corp. ("creditors have  
begun to demand advanced payment in return for deliveries of natural gas and power, and that if  
such demands continue, [the Debtor] expects to completely exhaust its cash reserves by the third  
week of January 2001. [The Debtor] is evaluating what additional steps it would need to take to  
preserve its ability to continue serving its customers. [The Debtor] must either raise substantial  
sums of new capital or default on its payment obligations."); Nancy River Brooks, *PG&E, Citing  
Cash Shortage, Warns of Natural Gas Cutoffs; Energy: Utility's Chief Executive Pleads With  
Governor To Use Emergency Powers To Help It Through Credit Crisis*, Los Angeles Times, Janu-  
ary 11, 2001 (reporting that the Debtor "warned Gov. Gray Davis that it may begin running out of  
natural gas in a few days unless he steps in to help it out of its latest credit crunch," and that the  
Debtor "said it has nearly run out of cash to make payments for both natural gas and electricity for  
its customers."). Request for Judicial Notice, ¶¶ 1-8, Exs. A-H.

1 was insolvent, and that it would be unable to pay more than \$1.5 billion in energy-related debts as  
2 they became due.<sup>3</sup>

3 It is indisputable that each of the foregoing disclosures, separately and in the aggregate, con-  
4 stituted an "Event of Default" under Section 5 of the ISDA and Section 11 of the Master Gas Agree-  
5 ment. Id. Ex. 6, (ISDA Master), Section 5, at 5; Ex. 1 (Master Gas Agreement), at 12. This, in turn,  
6 allowed SET, among other things, to exercise its rights under the ISDA to set off and estimate in  
7 good faith the amounts or obligations owed by the Debtor, thereby extinguishing any future amounts  
8 or obligations of SET to the Debtor. Id. Ex. 6 (ISDA Schedule), Section 5(c), at 11.<sup>4</sup> All that re-  
9 mained was the accounting contemplated by the ISDA. Id. At the time, SET estimated that the  
10 Debtor owed SET approximately \$70 million for electricity purchases. Id. ¶ 8. Accordingly, on  
11 January 18, 2001, SET notified the Debtor that SET had canceled, liquidated and terminated all  
12 transactions under the Master Gas Agreement and the ISDA and effected all applicable setoffs. Id.

13 **C. The Ongoing Dispute, and Debtor's Attempt to Compel SET to Waive Its Contractual Rights.**  
14

15 Approximately one week later, the Debtor objected to SET's setoff and, within a month, pur-  
16 ported to assert imbalance penalties under the GTSA against SET. Id. SET objected to the Debtor's  
17 position but, nevertheless, attempted to engage in discussions to resolve the outstanding issues.  
18 Id. ¶ 9. Although the Parties exchanged correspondence, no resolution of these issues occurred.<sup>5</sup> Fi-  
19 nally, in late March, the Debtor acknowledged that the parties' dispute also involved the Master Gas  
20 Agreement and the ISDA. Id. The Debtor then invoked the dispute resolution procedures set forth in  
21 the GTSA. Id. Within a week, and before that procedure had even begun, the Debtor filed its bank-  
22 ruptcy petition. Id.

23  
24 <sup>3</sup> In addition to the foregoing, SET also demanded adequate assurance which the Debtor  
25 failed to provide. This failure constituted a separate Event of Default under the Master Gas  
26 Agreement. Katz Decl. Ex. 1 (Master Gas Agreement), Article 11.1(e), at 12.

27 <sup>4</sup> "Any such setoff shall automatically satisfy and discharge the Original Obligation to the  
28 Defaulting Party ...." Id. Ex. 6 (ISDA Schedule), Section 5(c), at 11.

<sup>5</sup> For the sake of brevity, SET has omitted this correspondence from its motion. Should the  
Court require it, SET will make such correspondence available.

1           Appearing to have abandoned the dispute resolution process it had started, the Debtor advised  
2 SET in late April that the imbalance charges were continuing to accrue. Id. ¶ 10. However, the  
3 Debtor stated that it would *only* hold SET liable for such amounts if SET failed to return all the gas  
4 the Debtor claimed SET still owed. Id. Thus, the Debtor offered SET two choices: deliver the dis-  
5 puted gas or be liable for ever-increasing penalties. Id. In response, SET offered to deliver the gas  
6 the Debtor claimed it needed, with a provision for adequate protection pending a final resolution of  
7 the dispute. Yet, as soon as SET offered to deliver the gas, the Debtor changed the terms of its de-  
8 mand and advised SET that it would only accept *future* deliveries of gas beginning with the June  
9 2001 delivery. This change effectively deprived SET of its right, as provided for in the G-BAL, to  
10 deliver the Pre-June 2001 Gas in order to cure the alleged imbalance penalties. Moreover, this sud-  
11 den change was completely inconsistent with the parties' prior course of dealing pursuant to which  
12 the Debtor *never* imposed penalties and *always* resolved disputes in-kind or by agreement. At the  
13 same time, armed with the automatic stay, the Debtor intentionally created a situation in which SET  
14 could not, absent relief from this Court, obtain the arbitral adjudication which would free SET from  
15 the penalties and to which it was entitled pre-petition.

16           Faced with no other choice, under these circumstances, SET entered into the Stipulation with  
17 the Debtor to deliver gas commencing in June 2001. Request for Judicial Notice ¶ 10. Ex. J. In turn,  
18 SET will receive adequate protection from the Debtor in the event that a tribunal determines that SET  
19 had no obligation to deliver such gas. This interim resolution, however, does not resolve the dispute  
20 between the parties nor does it dissuade the Debtor from improperly seeking to impose penalties for  
21 SET's alleged failure to deliver the Pre-June 2001 Gas which the Debtor refuses to accept. Accord-  
22 ingly, as more fully set forth below, SET respectfully requests that this Court lift the automatic stay to  
23 allow the dispute resolution process to continue and permit SET to commence a mediation or arbi-  
24 tration proceeding in accordance with the contractual provisions of the GTSA. In addition, SET re-  
25 quests that the Court grant adequate protection for deliveries of the Pre-June 2001 Gas, which SET  
26 has offered to make and which the Debtor is obligated to accept under the Schedule G-BAL pending  
27 a determination of the arbitration panel.

SIROCK & SIROCK & LAMANT  
ATTORNEYS AT LAW  
2020 CENTURO PARK EAST, SUITE 1800  
LOS ANGELES, CALIFORNIA 90067-0886  
PHONE (310) 536-5800

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IV. ARGUMENT

A. The Automatic Stay Should Be Lifted to Allow the Debtor and SET to Arbitrate Their Dispute.

The Federal Arbitration Act (“FAA”) provides that arbitration clauses which establish a means to settle disputes arising out of written contracts involving commerce “shall be valid, irrevocable, and enforceable ....” 9 U.S.C. § 2. In this case, SET and the Debtor expressly agreed to arbitrate “[a]ny dispute, claim, or need for interpretation arising out of or relating to this GTSA.” GTSA ¶ 8.1, at 3. The current disputes between SET and the Debtor fall squarely within this provision of the GTSA: the Debtor contends that SET is obligated to make deliveries of natural gas under the GTSA, while SET contends that it has extinguished its obligations under the GTSA prior to the filing of this chapter 11 case.

In this Circuit, it is well-settled that the automatic stay must be lifted where an agreement between the parties contains a provision to arbitrate a non-core dispute.<sup>6</sup> MCI Telecomm. Corp. v. Gurga, (In Re Gurga), 176 B.R. 196, 197 (Bankr. 9<sup>th</sup> Cir. 1997). In that case, the Bankruptcy Appellate Panel (the “BAP”) held that the bankruptcy court had no discretion to refuse to enforce an arbitration provision in the parties’ pre-petition agreement, and that the court should have granted the creditor relief from the automatic stay to allow the arbitration of debtor’s non-core claims. In reaching this conclusion, the BAP relied on Supreme Court authority and congressional policy favoring arbitration. Id. at 199-200, *citing to Moses H. Cone Memorial Hosp. V. Mercury Constr. Corp.*, 460 U.S. 1, 24, 103 S. Ct. 927, 941, 74 L.Ed.2d 765 (1983) and Graham Oil Co. v. ARCO Products, Inc., 43 F.3d 1244 (9<sup>th</sup> Cir. 1994). See also In re Morgan, 28 B.R. 3, 5 (9<sup>th</sup> Cir. B.A.P. 1983) (a debtor-in-possession is bound by the mandatory arbitration provisions contained in a contract where he makes a claim arising out of that contract).

Other circuits agree. E.g., Hays, 885 F.2d at 1149 (lifting the stay to enforce an arbitration clause and holding that where a proceeding does not involve a right created by federal bankruptcy

<sup>6</sup> A non-core proceeding is defined as a proceeding which does not involve a right created by federal bankruptcy law. See, e.g., Hays & Co. v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 885 F.2d 1149 (3<sup>rd</sup> Cir. 1989).

1 law, it is a non-core proceeding); In re Jotan, Inc., 232 B.R. 503 (Bankr. M.D. Fla. 1999) (granting  
2 relief from stay to permit arbitration to proceed in accordance with clause in Debtor's pre-petition  
3 contract because it involved a non-core dispute which arose outside bankruptcy and would facilitate  
4 administration of estate); In re Bicoastal Corp., 111 B.R. 999, 1002 (Bankr. M.D. Fla. 1990) (lifting  
5 stay for purpose of submitting pre-petition contract dispute to arbitration because it had only a mini-  
6 mal impact on the administration of Debtor's bankruptcy estate); Fallick v. Kehr, 369 F.2d 899, 904  
7 (2d Cir. 1966) (binding a bankruptcy debtor to a pre-petition arbitration agreement); In re Guy C.  
8 Long, Inc., 90 B.R. 99 (Bankr. E.D. Pa. 1988) (concluding that an arbitration clause was enforceable  
9 against a Chapter 11 debtor); Barber Greene Co. v. Zeco Co., 17 B.R. 248, 250 (Bankr. D. Minn.  
10 1982) (enforcing arbitration clause against a Chapter 11 debtor); In re Cres Rivera Concrete Co., 21  
11 B.R. 155 (Bankr. D. N.M. 1982) (ordering arbitration against a Chapter 7 debtor).

12 Here, the controversy between the Debtor and SET is identical to the situation in Gurga since  
13 it is predicated upon a non-core dispute for breach of various pre-petition contracts. Indeed, the in-  
14 stant case does not involve the arbitration of any substantive bankruptcy issues. It simply seeks a  
15 determination of whether SET properly exercised its contractual rights under the ISDA and the Mas-  
16 ter Gas Agreement. Moreover, because the GTSA contains a mandatory arbitration provision, the  
17 same congressional and judicial policy favoring arbitration is implicated. Gurga, 176 B.R. at 198;  
18 BiCoastal, 111 B.R. at 1001.

19 In addition, because the arbitration in this case would involve determinations under com-  
20 modity trading contracts, a seasoned arbitration panel is better suited to hear the dispute, foster judi-  
21 cial economy within this Court, and further the efficient reorganization of Debtor. See Edgerton v.  
22 Shearson Lehman Brothers, Inc. (In Re Edgerton), 98 B.R. 392, 395 (Bankr. N.D. Ill. 1989) (where  
23 pre-petition brokerage contract contained an arbitration clause, court lifted stay and allowed arbitra-  
24 tion to proceed because the issues set forth involved sophisticated and complex trading practices);  
25 BiCoastal, 111 B.R. at 1002 (lifting stay for purpose of submitting pre-petition contract dispute to  
26 arbitration because it involved accounting issues specifically tailored to arbitration and because arbi-  
27 tration assisted in an efficient reorganization of debtor); Garland Coal & Mining Co. v. United Mine  
28

1 Workers of America, 778 F.2d 1297, 1304 (8<sup>th</sup> Cir. 1985) (lifting automatic stay to allow the merits  
2 of a labor dispute to be resolved through arbitration).

3 In late March 2001, the Debtor, pre-petition, invoked the alternative dispute resolution proce-  
4 dure set forth in the GTSA, although it failed to follow through with that demand and no arbitration  
5 proceeding was ever commenced. Continuing the dispute resolution process provided by the GTSA  
6 and commencing an arbitration proceeding to resolve the dispute between SET and the Debtor is now  
7 manifestly appropriate under the circumstances and required as a matter of law upon SET's request.  
8 Accordingly, this Court should grant SET relief from the automatic stay, and allow the parties to re-  
9 solve all of their disputes before an appropriate arbitration panel.

10 **B. Even If The Dispute Between The Parties Included Core Matters, Relief From Stay To**  
11 **Commence An Arbitration Proceeding Is Appropriate.**

12 While it is clear that the disputes between SET and the Debtor are non-core matters arising  
13 from pre-petition contracts between the parties, even if the disputes included core matters, it would  
14 be appropriate to permit these disputes to be resolved by arbitration. Courts have regularly granted  
15 relief from stay to permit arbitration even in core matters, where the issues in dispute do not involve  
16 questions of federal bankruptcy law. E.g., Insurance Co. of N. Am. v. NGC Settlement Trust & As-  
17 bestos Claims Management Corp. (In the Matter of Nat'l Gypsum Co.), 118 F.3d 1056, 1068 (5th  
18 Cir. 1997) (denying relief from stay to permit arbitration of core matter that only peripherally related  
19 to non-bankruptcy law and pre-petition contracts, but stating: "In the most common type of creditor-  
20 initiated proceeding — a motion for relief from the automatic stay — bankruptcy courts regularly  
21 have permitted arbitration to continue (or commence) in spite of the presence of core bankruptcy ju-  
22 risdiction. In those cases permitting arbitration, courts have typically found little difficulty with arbi-  
23 tration of disputes where resolution would not involve matters of federal bankruptcy law").

24 This principle is best illustrated by the case of In re Statewide Realty Co., 159 B.R. 719  
25 (Bankr. D. N.J. 1993). In that case, the debtor objected to claims advanced by Hilton International  
26 under a rejected management agreement. Hilton sought relief from the automatic stay to resolve the  
27 claims pursuant to an arbitration provision in the contract. In permitting the dispute to be resolved by  
28 the contractually mandated arbitration provision, the Court stated:

1 The fact that the matter before the court is a core proceeding does not mean that  
2 arbitration is inappropriate. The substance of the debtor's objection to the Hilton  
3 International claim is derived from or governed by the very same Management  
4 Agreement between the parties which contains the arbitration clause. While it is true  
5 that a significant portion of the claim stems from damages that result from the  
6 debtor's rejection of the Management Agreement pursuant to Bankruptcy Code  
7 section 365, the bankruptcy issues as to whether rejection of the Management  
8 Agreement was a proper exercise of the debtor's business judgment have already been  
9 determined in the hearings conducted by the court. Assessment of the allowable  
10 amount of damages which result from the rejection requires merely the application of  
11 contract law - a matter in which the arbitrator has equal, or perhaps greater,  
12 experience than the bankruptcy court.

13 Id. at 724. See also In re Chorus Data Systems, Inc., 122 B.R. 845, 852 (Bankr. D.N.H. 1990)  
14 (arbitration clause enforced even where core issues present).

15 Here, all of the issues to be resolved relate to pre-petition agreements and events. While the  
16 Debtor may attempt to locate a core matter embedded in these disputes that arises exclusively under  
17 non-bankruptcy law, it is clear that these matters should be resolved through the contractually agreed  
18 upon arbitration process. The arbitration panel is likely to have a greater understanding of the com-  
19 plex provisions of the GTSA, the Master Gas Agreement, the ISDA and the schedules and transac-  
20 tions thereunder.<sup>7</sup> Moreover, the arbitration panel will not be burdened by the myriad of other mat-  
21 ters that this Court is being asked to resolve in this highly complex chapter 11 case.

22 **C. The Debtor Cannot Use The Automatic Stay To Avoid The Arbitration Provisions Of**  
23 **The GTSA To Improve Its Position.**

24 In the instant case, the Debtor appears content to avoid a resolution of the dispute with SET,  
25 alleging the accrual of ever increasing penalties against SET and hiding behind the automatic stay to

26 \_\_\_\_\_  
27 <sup>7</sup> The arbitration panel is comprised of three arbitrators: the parties each pick one arbitrator  
28 and these two arbitrators, in turn, pick a neutral third arbitrator. Katz Decl. Ex. 2 (GTSA), ¶ 8.3.1,  
at 3.

1 prevent SET from obtaining a prompt determination of its dispute.<sup>8</sup> Courts have long held that a  
2 debtor may not use the automatic stay as an offensive weapon to improve its position in litigation.  
3 For example, in deciding cases involving the ability of a non-debtor party to file a counterclaim in  
4 litigation being prosecuted by a debtor, courts have consistently held that such an attempt to use the  
5 automatic stay to enhance the debtor's litigation position was impermissible. In re Bohack Corp.,  
6 599 F.2d 1160 (2d Cir. 1979) ("The purpose [of the automatic stay] is the protection of the debtor,  
7 but when the debtor is in the position of assailant rather than victim, the potential for abuse of that  
8 purpose is manifest."); In re Pro Football Weekly, Inc., 60 B.R. 824, 826 (N.D. Ill. 1986) (lifting stay  
9 where creditor would be "prejudiced ... because it w[ould] be unable to fully defend its position"  
10 against the debtor, and the debtor would not suffer "any hardship ... if all the[] claims are adjudicated  
11 in one proceeding"); In re Bailey, 11 B.R. 199, 201 (E.D. Va. 1981) (lifting stay to permit limited  
12 discovery of the debtor because "[a]ny other decision to the contrary would be clearly inequitable, for  
13 it would allow the [debtor] to pursue a claim against the Plaintiff without giving the Plaintiff the op-  
14 portunity to defend itself"); Bernstein v. IDT Corp., 76 B.R. 275 (S.D.N.Y. 1987) (quoting Bohack  
15 and stating that "[t]o deny [the creditor] the assertion of properly pleaded counterclaims would allow  
16 the Trustee to use the stay as a sword instead of a shield"); In Hydramar v. General Dynamics Corp.,  
17 1986 U.S. Dist. LEXIS 24828, \* 13-14 (E.D. Pa. May 10, 1986) ("[T]he purpose of the rule granting  
18 a debtor relief by reason of the automatic stay is to protect debtors from legal harassment. That pur-  
19 pose has no application where the debtor is in the position of the assailant rather than the victim. Too  
20 great a potential abuse of the bankruptcy procedures exists in such a situation.")

21 Here, the Debtor is attempting to accomplish essentially the same inequitable result that was  
22 addressed in the foregoing cases. The Debtor is continuing to assess — however improperly —  
23 enormous penalties against SET, but refusing to allow SET recourse to a contractually agreed upon  
24 arbitration proceeding to resolve the dispute and cease the alleged accrual of these penalties. By at-

25 \_\_\_\_\_  
26 <sup>8</sup> SET requested that the Debtor agree to allow the immediate arbitration of the dispute with  
27 the Debtor. However, the Debtor refused to agree to allow arbitration of the central dispute of  
28 whether the obligations of the Debtor to SET for electricity purchases could be offset against  
SET's obligations to deliver gas to the Debtor pursuant to the express language of the agreements  
between the parties.

1 tempting to continuously increase the exposure to SET, the Debtor is attempting to force SET to ac-  
2 cede to its position simply because even the small risk of a crushing penalty cannot be prudently tol-  
3 erated by SET. While the Debtor may have the right to assert its position that the penalties continue  
4 to accrue, it cannot — at the same time — use the automatic stay to avoid a resolution of the dispute  
5 that gives rise to its allegations. Accordingly, relief from stay is appropriate to permit the dispute  
6 between SET and the Debtor to be resolved expeditiously by an arbitration tribunal.

7 **D. Pending the Resolution of the Dispute Between the Parties, SET is Entitled to Adequate**  
8 **Protection for Post-Petition Gas Deliveries.**

9 Since January 2001, the Debtor has demanded that SET deliver gas and cure its imbalances  
10 pursuant to the GTSA and the G-BAL.<sup>9</sup> Under the G-BAL, the Debtor and SET are required to  
11 “reach agreement ... to make up such imbalance in-kind during a specified period and at a specific  
12 rate” within 30 days of the month in which the underdelivery occurred. Katz Decl. Ex. 3, at 12. SET  
13 has offered and stands ready to make the deliveries respecting the gas previously scheduled to be de-  
14 livered prior to June 2001. The Debtor simply *cannot* transform the automatic stay into a sword by  
15 refusing to take delivery and imposing penalties without end. Upon delivery of such gas, SET is en-  
16 titled to an order granting SET adequate protection of its interest therein in the event it is subse-  
17 quently determined that SET was not obligated to deliver such gas to Debtor.

18 It is fundamental that SET is entitled to adequate protection of its interest in any natural gas it  
19 delivers to the Debtor post-petition under 11 U.S.C. § 363(e), which provides that:

20 at any time, on request of an entity that has an interest in property used, sold or leased,  
21 or proposed to be used, sold or leased by the [debtor], the court . . . shall prohibit or  
22 condition such use, sale or lease as is necessary to provide adequate protection of such  
23 interest.

24 11 U.S.C. § 363(e).

27 <sup>9</sup> In light of the fact that the parties netted imbalances in ways not contemplated by the G-  
28 BAL under the parties’ prior course of dealing, it is arguable that the G-BAL even applies.

1 Here, SET owns the gas<sup>10</sup> it seeks to deliver to the Debtor pending a resolution of their dis-  
2 pute. Because the Debtor intends to use this gas, and because gas is a non-renewable commodity  
3 whose value instantly vanishes upon the Debtor's use, SET is entitled to adequate protection of its  
4 ownership interest in such gas. Where the property is sold or depreciates, the notion of "adequate  
5 protection" requires replacement or payment so that the value of the creditor's interest is not depreci-  
6 ated. In re Prime, Inc., 35 B.R. 697, 699 (Bankr. W.D. Mo. 1984); In re Falwell Excavating Co., Inc.,  
7 47 B.R. 217, 219 (Bankr. W.D. Va. 1985) (adequate protection can be provided to party that holds an  
8 interest in property where use would decrease its value).

9 Indeed, even where a debtor is entitled to turnover, it is well-settled that under such circum-  
10 stances the creditor would be entitled to receive adequate protection as a matter of law. United States  
11 v. Whiting Pools, Inc., 462 U.S. 198, 207, 103 S. Ct. 2309 (1983); In re Lyon, 193 B.R. 637 644,  
12 (Bankr. D.Mass. 1996); In re Quality Health Care, 215 B.R. 543, 574 (Bankr. N.D. Ind. 1997); In re  
13 Empire for Him, Inc., 1 F.3d 1156 (11<sup>th</sup> Cir. 1993) (holding that a bankruptcy court exceeds its equi-  
14 table power by ordering turnover of property held by creditor without providing for adequate protec-  
15 tion).

16 Similarly, a creditor who pays a pre-petition debt to which it otherwise has a right of setoff is  
17 entitled to adequate protection for such payment. In re Sluss, 107 B.R. 599, 604 (Bankr. E.D. Tenn.  
18 1989) (creditor is entitled to adequate protection as a prerequisite to payment of pre-petition debt to

19 <sup>10</sup> At one point, the Debtor threatened to compel SET to deliver the disputed gas by way of a  
20 turnover motion. Although it appears that the Debtor has abandoned this threat, even if the Debtor  
21 renews its threat a turnover motion should fail under the circumstances at bar since, as set forth  
22 above, the Debtor's right to the gas is in dispute. See In re Orthotic Center, Inc., 193 B.R. 832,  
23 834 (Bankr. N.D. Ohio 1996) (debtor cannot use turnover provision to liquidate contract dispute or  
24 otherwise demand property whose title is in dispute); Trefny v. Bear Stearns Securities Corp., 243  
25 B.R. 300, 320 (S.D. Tex. 1999) (turnover proceedings under Bankruptcy Code are not to be used  
26 to liquidate disputed contract claims); In re Tillery, 179 B.R. 576, 580 (Bankr. W.D. Ark. 1995)  
27 (creditor is not required to turnover property of the estate with regard to which setoff rights exist);  
28 In re Lauria, 243 B.R. 705, 708 (Bankr. N.D. Ill. 2000) (turnover is not intended as a remedy to  
determine disputed rights in property; rather it is intended as a remedy to obtain what is acknowl-  
edged to be property of the estate); In re Litenda Mortgage Corp., 246 B.R. 185, 195 (Bankr.  
D.N.J. 1999) (turnover claim will not lie where bona fide dispute exists as to debtor's entitlement  
to property in question); In re Allegheny Health, Educ. & Research Foundation, 233 B.R. 671,  
677 (Bankr. W.D. Pa. 1999) (turnover action cannot be used to demand assets whose title is in dis-  
pute). In any event, for the reasons set forth in the text, even a "turnover" of natural gas by SET to  
the Debtor would be conditioned upon the provision by the Debtor of adequate protection for  
SET's interest in any property turned over.

1 debtor against which it claims a right of setoff); In re IML Freight, Inc., 65 B.R. 788, 791 (Bankr.  
2 D.Utah 1986) (bankruptcy trustee has rights to use property that is subject to setoff, provided ade-  
3 quate protection is given); International Horizons (Curacao), N.V. v. Western Publishing Co., Inc. (In  
4 re International Horizons, Inc.), 15 B.R. 798, 801 (Bankr. N.D. Ga. 1981), rev'd on other grounds, 21  
5 B.R. 414 (N.D. Ga. 1982) (adequate protection provided to creditor ordered to turnover property to  
6 the estate pending a determination of the extent of the creditor's interest in such property).

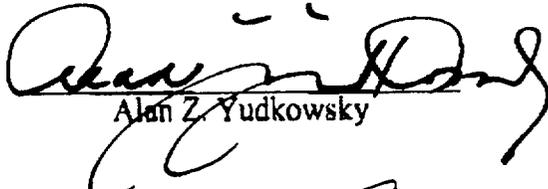
7 In the event the Debtor is correct and SET was obligated to deliver the Pre-June 2001 Gas  
8 under the GTSA, the adequate protection will not cause any harm or hardship to the estate. In the  
9 event SET is correct and it had no obligation to deliver this gas to the Debtor, the adequate protection  
10 will merely assure SET of payment for its post-petition delivery of SET's gas in response to the  
11 Debtor's disputed demand for such delivery. Under such circumstances, SET is entitled to adequate  
12 protection as a matter of law.

### 13 V. CONCLUSION

14 For the foregoing reasons, Sempra Energy Trading Corp. respectfully requests that this Court  
15 enter an order (1) lifting the automatic stay to allow the parties to resolve all of their disputes before  
16 an appropriate arbitration panel; and (2) granting Sempra Energy Trading Corp. adequate protection  
17 for the Pre-June 2001 Gas it delivers to the Debtor post-petition.

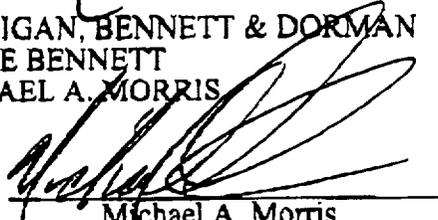
18 Dated: June 4, 2001

19 STROOCK & STROOCK & LAVAN LLP  
20 LEWIS KRUGER  
21 ALAN Z. YUDKOWSKY  
22 PETER JAZAYERI

23 By: 

Alan Z. Yudkowsky

24 HENNIGAN, BENNETT & DORMAN  
25 BRUCE BENNETT  
26 MICHAEL A. MORRIS

27 By: 

Michael A. Morris

28 Attorneys for Party-in-Interest  
SEMPRA ENERGY TRADING CORP.

**PROOF OF SERVICE**

STATE OF CALIFORNIA, COUNTY OF LOS ANGELES

I am employed in the County of Los Angeles, State of California. I am over the age of 18 and not a party to the within action. My business address is Stroock & Stroock & Lavan LLP, 2029 Century Park East, Suite 1800, Los Angeles, California 90067-3086.

On June 4, 2001, I served the foregoing document described as **NOTICE OF MOTION AND MOTION OF SEMPRA ENERGY TRADING CORP. FOR RELIEF FROM STAY AND FOR ADEQUATE PROTECTION [11 U.S.C. § 362(d)(1), LOCAL BANKRUPTCY RULES 4000-1 AND 9013-1]; MEMORANDUM OF POINTS AND AUTHORITIES IN SUPPORT THEREOF** on the interested parties in this action by placing a true copy thereof enclosed in sealed envelopes addressed as follows:

SEE ATTACHED SERVICE LIST

XX (BY MAIL) In accordance with the regular mail collection and processing practices of this business office, with which I am readily familiar, by means of which mail is deposited with the United States Postal Service at Los Angeles, California that same day in the ordinary course of business, I deposited such sealed envelope, with postage thereon fully prepaid, for collection and mailing on this same date following ordinary business practices.

       (BY PERSONAL SERVICE)

- By personally delivering such envelope to the addressee.
- By causing such envelope to be delivered by messenger to the office of the addressee.
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**FEDERAL**

XX I declare under penalty of perjury that the above is true and correct (and that I am employed in or by the office of a member of the bar of this Court at whose direction the service was made). Executed on June 4, 2001, at Los Angeles, California.

Regina Harcourt  
[Type or Print Name]

  
[Signature]

STROOCK & STROOCK & LAVAN LLP  
ATTORNEYS AT LAW  
2029 CENTURY PARK EAST, SUITE 1800  
LOS ANGELES, CALIFORNIA 90067-3086  
PHONE (310) 556-5800

**SERVICE LIST**  
[Case No. 01-30923 DM]

1		
2		
3	Adam A. Lewis	Bank of America National Trust
4	Morrison & Foerster	and Savings Association
5	425 Market Street, 33rd Floor	CA5-705-12-10
6	San Francisco, California 94105	Attn: Adeline Tourunian
7	[Counsel for El Paso]	555 California Street, 12th Floor
8		San Francisco, CA 94104
9	Adam A. Lewis	
10	Morrison & Foerster	Bank of America
11	425 Market Street, 33rd Floor	Attn: Clara Strand
12	San Francisco, California 94105	555 South Flower Street
13	[Counsel for Idaho Power]	Mail Code CA9-706-11-21
14		Los Angeles, CA 90071
15	Adrienne Vadell Sturges	
16	Sodexho Marriott Services, Inc.	Bank of America, N.A.
17	9801 Washingtonian Boulevard	Admin. Agent
18	12th Floor	Katherine Kemerait
19	Gaithersburg, MD 20878	Bank of America
20		555 California Street, 12th Floor
21	Alex Makler	San Francisco, CA 94104-1502
22	Calpine Corporation	
23	6700 Koll Center Parkway, Suite 200	Bank One
24	Pleasanton, California 94566	Corporate Trust Administration
25		Attn: Janice Ott Rotunno
26	Arlen Orchard	Mail Code IL1-0126
27	Sacramento Municipal Utility District	1 Bank One Plaza
28	6201 S. Street, Mail Stop B408	Chicago, IL 60670-0126
	Sacramento, California 95817	
		Bank One, NA
	Aron Mark Oliner	Attn: Robert G. Bussa, Jane Bek
	Buchalter, Nemer, Fields & Younger	Energy & Utilities
	A Professional Corporation	Mail Code IL 1-0363
	333 Market Street, 29th Floor	Bank One Plaza
	San Francisco, California 94105	Chicago, IL 60670
	[Counsel for MBIA Insurance Corporation]	
		Bankers Trust Co. of California, NA
	B.C. Barmann, Sr.	Structured Finance Group
	County Counsel	Attn: Peter Becker
	Attn: Jerri S. Bradley, Deputy	4 Albany St., 10th Floor
	1115 Truxtun Avenue, Fourth Floor	New York, NY 10006
	Bakersfield, California 93301	
	[Counsel for Phil Franey, Treasurer/	Bankers Trust Company
	Tax Collector for Kern County]	Corporate Trust Services
		Attn: Safet Kalabovic
	Bank of America National Trust	4 Albany Street, 4th Floor
	and Savings Association	New York, NY 10006
	Attn: Peggie Sanders	
	1850 Gateway Boulevard	Banque Nationale de Paris
	Concord, CA 94520	San Francisco Branch
		Attn: Debra Wright
		180 Montgomery St., 4th Floor
		San Francisco, CA 94104

1 Ben Whitwell  
Whitwell & Emhoff LLP  
2 202 N. Canon Drive  
Beverly Hills, California 90210  
3 [Attorney for California Power Exchange]  
4 Bennett G. Young  
LeBoeuf, Lamb, Greene & MacRae, LLP  
5 One Embarcadero Center, Suite 400  
San Francisco, California 94111  
6 [Counsel for Enron North America Corp  
and Enron Canada Corp.]  
7 Beth Smayda, Director  
8 MBLA Insurance Corporation  
113 King Street  
9 Armonk, New York 10504  
10 BMO Nesbitt Burns  
Attn: John Harche  
11 700 Louisiana, Suite 4400  
Houston, TX 77002  
12 BNY Western Trust Company  
13 Attn: Rose Ruelos  
Corp. Trust Administration  
14 550 Kearny St., Suite 600  
San Francisco, CA 94108-2527  
15 BP Energy Company  
16 Attn: Louis Anderson  
501 Westlake Park Blvd  
17 Houston, TX 77079  
18 BP Energy Company  
Attn: Ken McClanahan  
19 501 Westlake Park Boulevard  
Houston, Texas 77079  
20 Brian L. Holman  
21 Neil W. Rust  
White & Case LLP  
22 633 West Fifth Street, 19th Floor  
Los Angeles, California 90071  
23 [Counsel for Mirant Corporation]  
24 Bruce Bennett, Esq.  
Bennett J. Murphy, Esq.  
25 Hennigan Bennett & Dorman  
601 South Figueroa St., Suite 3300  
26 Los Angeles, CA 90017  
[Counsel for Semptra and  
27 Southern California Gas Company]  
28

Bryan Krakauer, Esq.  
Sidley & Austin  
One First National Plaza  
Chicago, IL 60603  
[Attorney for Bank of America,  
Admin. Agent]

Bryant Danner  
Southern California Edison  
2244 Walnut Grove Ave.  
Rosemead, CA 91770

California Farm Bureau Federation  
2300 River Plaza Drive  
Sacramento, California 95833

California Independent System Operator  
Margaret A. Rostker  
P.O. Box 639014  
Folsom, CA 95630-9017

California Independent System Operator  
Attn: Margaret A. Rostker  
4151 Blue Ravine Rd.  
Folsom, CA 95630

California Power Exchange  
Attn: Don Deach  
100 S. Fremont Ave., Bldg. A9  
Alhambra, CA 91803-4737

California Power Exchange  
Attn: Lynn Miller  
2000 S. Los Robles Avenue  
Suite 400  
Pasadena, CA 91101-2482

California Power Exchange  
Lynn Miller  
100 S. Fremont Avenue, Bldg A9  
Alhambra, CA 91803-4737

California Public Utilities Commission  
Alan Kornberg, Esq.  
Paul, Weiss, Rifkind, Wharton & Garrison  
1285 Avenue of the Americas  
New York, NY 10019-6064  
[Attorney for California Public Utilities Commission]

California Public Utilities Commission  
Attn: General Counsel  
505 Van Ness Avenue  
San Francisco, CA 94102

1 California State Board of Equalization  
PO Box 942879  
2 Sacramento, CA 94279-8063  
3 Calpine Gilroy Cogeneration LP  
Robert Brown  
4 6700 Koll Center Pky #200  
San Jose, CA 94566  
5 Calpine Greenleaf Inc.  
6 465 California St. #600  
San Francisco, CA 94104  
7 Calpine King City Cogen LLC  
8 Robert Brown  
6700 Kill Center Pky #200  
9 San Jose, CA 94568  
10 Calpine Pittsburg Power Plant  
Zahir Ahmadi  
11 50 W. San Fernando St.  
San Jose, CA 95113  
12 Carl A. Eklund  
13 LeBoeuf, Lamb, Greene & MacRae, LLP  
125 West 55th Street  
14 New York, NY 10019  
[Counsel for Enron North America Corp  
15 and Enron Canada Corp.]  
16 Chaim J. Fortgang, Esq.  
Richard G. Mason, Esq.  
17 Wachtell, Lipton, Rosen & Katz  
51 West 52nd Street  
18 New York, NY 10019  
[Counsel for Unofficial Committee of  
19 Pacific Gas & Electric Company  
First Mortgage Bondholders]  
20 Chevron U.S.A. Production Co.  
21 P.O. Box 840659  
Dallas, TX 75284-0659  
22 Christine C. Yokan  
23 General Electric Capital Business  
Asset Funding Corp.  
24 10900 N.E. 4th Street, Suite 500  
Bellevue, Washington 98004  
25 Christopher Beard  
26 Beard & Beard  
306 N. Market Street  
27 Frederick, MD 21701  
28

Coast Energy Canada Inc.  
Attn: Caroline Pitre  
444-7<sup>th</sup> Avenue S.W., Suite 700  
Calgary, Alberta  
Canada T2P 0X8  
Coast Energy Group, A Division of  
Cornerstone Propane, L.P.  
Attn: Ruben Alonso  
1600 Highway 6, Suite 400  
Sugarland, TX 77478  
Cook Inlet Energy Supply  
Attn: Hans O. Saeby  
10100 Santa Monica Blvd., 25<sup>th</sup> Floor  
Los Angeles, CA 90067  
Craig H. Millet  
Gibson Dunn & Crutcher LLP  
Jamboree Center  
4 Park Plaza, Suite 1400  
Irvine, California 92614  
[Counsel for Tucson Electric  
Power Company]  
Crocket Cogen  
A California Limited Partnership  
Keith Richards  
135 S. LaSalle Street, #1960  
Chicago, IL 60603  
David A. Burns  
Baker Botts LLP  
One Shell Plaza  
910 Louisiana  
Houston, TX 77002  
[Counsel for Reliant Energy, Inc.]  
David A. Gill  
Richard K. Diamond  
Danning, Gill, Diamond & Kollitz LLP  
2029 Century Park East, Third Floor  
Los Angeles, CA 90067  
[Counsel for Interested Party,  
Department of Water and Power]  
David J. Hankey  
Gohn, Hankey & Stichel LLP  
Suite 1520, The Fidelity Building  
210 North Charles Street  
Baltimore, Maryland 21201  
[Counsel for Corestaff Services  
(California), Inc.]

1 David L. Ronn  
Mayer, Brown & Platt  
2 700 Louisiana, Suite 3600  
Houston, Texas 77002  
3 [Counsel for Cook Inlet Energy Supply]

4 David Neale  
Levene, Neale, Bender,  
5 Rankin & Brill LLP  
1801 Avenue of the Stars, Suite 1120  
6 Los Angeles, California 90067  
[Counsel for California Independent  
7 System Operator, Inc.]

8 David T. Biderman  
Perkins Coie LLP  
9 1620 26th Street, Sixth Floor  
Santa Monica, CA 90404-4013  
10 [Counsel for Bank of Montreal]

11 Department of Justice  
U.S. Attorney's Office  
12 450 Golden Gate Avenue  
Box 36055  
13 San Francisco, CA 94102

14 Deutsche Bank AG  
New York Branch  
15 Attn: E.S. Medla  
31 West 52nd Street  
16 New York, NY 10019

17 Deutsche Bank AG  
New York Branch  
18 Attn: John Quinn  
31 West 52nd Street  
19 New York, NY 10019

20 DK Acquisition Partners, L.P.  
c/o M.H. Davidson & Co.  
21 Attn: Tony Yoseloff  
885 Third Avenue, Suite 3300  
22 New York, NY 10022

23 Don Gaffney  
Snell & Wilmer LLP  
24 One Arizona Center  
400 East Van Buren  
25 Phoenix, AZ 85004  
[Counsel for Arizona Public Service Co.]

26  
27  
28

Duane H. Nelsen  
GWF Power Systems Company, Inc.  
4300 Railroad Ave.  
Pittsburgh, CA 94565-6006

Dulcie D. Brand  
Ricky L. Shackelford  
James L. Poth  
Jones Day Reavis & Pogue  
555 West Fifth Street, Suite 4600  
Los Angeles, California 90013  
[Counsel for Williams Energy Services and Williams En-  
ergy Marketing]

Dynergy Canada Marketing & Trade  
Attn: Steve Barron  
350 - 7th Avenue S.W.  
Calgary, Alberta  
Canada, T2P 3N9

Dynergy Marketing & Trade  
Attn: Steve Barron  
1100 Louisiana Street, Suite 5800  
Houston, Texas 77002

Edwin Berlin  
Richard Wyron  
Swidler Berlin Shereff Friedman, LLP  
3000 K Street, N.W.  
Washington, DC 20007  
[Counsel for California Independent System Operator, Inc.]

Ellen K. Wolf  
Michael S. Abrams  
Gilchrist & Rutter  
Wilshire Palisades Building  
1299 Ocean Avenue, Suite 900  
Santa Monica, CA 90401-1000  
[Counsel for IBM Corporation]

El Paso Merchant Energy Gas LP  
Darrel Rogers  
2500 City West Blvd., Suite 1400  
Houston, TX 77042

El Paso Merchant Energy, L.P.  
Attn: John Harrison  
1010 Travis Street  
Houston, Texas 77002

- |    |   |  |
|----|---|--|
| 1  | Elaine M. Seid<br>McPharlin, Sprinkles & Thomas LLP                                 | Geysers Power Company LLC<br>Joe McClendon<br>6700 Koll Center Pky #200<br>Pleasanton, CA 94566  |
| 2  | 10 Alamaden Boulevard, Suite 1460<br>San Jose, California 95113                     |  |
| 3  | [Counsel for City of Santa Clara]   |  |
| 4  | Enron Canada Corporation<br>3500 Canterra Tower                                     | Glenn M. Reisman<br>Two Corporate Drive<br>P.O. Box 861<br>Shelton, CT 06484   |
| 5  | 400 3rd Ave. S.W.<br>Calgary, AB T2P 4H2  | [Counsel for GE Power Systems and<br>GE Supply Divisions]  |
| 6  | Canada  |  |
| 7  | Howard S. Beltzer<br>Evan Hollander   | Gordon P. Erspamer<br>Morrison & Foerster LLP  |
| 8  | Daniel P. Ginsberg<br>White & Case  | 101 Ygnacio Valley Road, Suite 450<br>P.O. Box 8130<br>Walnut Creek, California 94595  |
| 9  | 1155 Avenue of the Americas<br>New York, NY 10036                                   | [Counsel for AES New Energy, Inc.]   |
| 10 | [Counsel for BNY]   |  |
| 11 | Evelyn H. Biery<br>Corestaff Services (California), Inc.                            | Grant Kolling<br>City of Palo Alto<br>P.O. Box 10250<br>Palo Alto, California 94303  |
| 12 | Fulbright & Jaworski LLP<br>1301 McKinney, Suite 5100                               |  |
| 13 | Houston, Texas 77010<br>[Counsel for Corestaff Services<br>(California), Inc.]      | Gregory W. Jones<br>El Paso Merchant Energy<br>1001 Louisiana, Suite 2754B<br>Houston, Texas 77002   |
| 14 | Fernando De Leon<br>Attorney at Law   |  |
| 15 | California Energy Commission<br>1516 9th Street, MS-14                              | GWF Power Systems LP<br>4300 Railroad Ave.<br>Pittsburg, CA 94565  |
| 16 | Sacramento, California 95814  |  |
| 17 | Franchise Tax Board<br>P.O. Box 942857  | Harold L. Kaplan<br>Jeffrey M. Schwartz<br>Mark F. Hebbeln<br>Gardner, Carton & Douglas<br>321 North Clark Street, 34th Floor<br>Chicago, IL 60610 |
| 18 | Sacramento, California 94257-2021   | [Counsel for Indenture Trustee for<br>7.90% Deferrable Interest<br>Subordinated Debendures Series A]   |
| 19 | G. Larry Engel<br>Roberto J. Kampfner   |  |
| 20 | Brobeck, Phleger & Harrison LLP<br>One Market                                       |  |
| 21 | Spear Street Tower<br>San Francisco, California 94105                               | Heather Brown<br>Williams Energy Marketing and Trading Co.<br>One Williams Center, Suite 4100<br>Tulsa, OK 74172                                   |
| 22 | [Counsel for City of Palo Alto<br>and its municipality utility]                     |  |
| 23 | Gary P. Blitz<br>Piper Marbury Rudnick & Wolfe LLP                                  | Heinz Binder<br>Robert G. Harris<br>Binder & Malter<br>2775 Park Avenue<br>Santa Clara, California 95050   |
| 24 | 1200 19th Street, N.W.<br>Washington, D.C. 20036                                    | [Counsel for Corestaff Services (California), Inc.]  |
| 25 | [Counsel for Certain Underwriters<br>at Lloyd's and Interested Insurance Companies] |  |
| 26 |   |  |
| 27 |   |  |
| 28 |   |  |

- 1 Howard J. Weg  
Peitzman, Glassman & Weg  
2 1900 Avenue of the Stars, Suite 650  
Los Angeles, California 90067  
3 [Counsel for Powerex Corp.]
- 4 Hydee R. Feldstein  
Katherine A. Traxler  
5 Kelly Aran  
Paul, Hastings, Janofsky & Walker LLP  
6 Twenty Third Floor  
555 South Flower Street  
7 Los Angeles, California 90071  
[Counsel for Constellation Power Source, Inc.]
- 8 ICC Energy Corporation  
9 Attn: Karl Butler  
302 N. Market Street, Suite 500  
10 Dallas, TX 75202-1846
- 11 Internal Revenue Service  
Fresno, CA 93888
- 12 Internal Revenue Service  
13 Spec Proc / Bankruptcy  
1301 Clay Street, Suite 1400  
14 Oakland, CA 94612
- 15 J. Christopher Kennedy  
Irell & Manella LLP  
16 1800 Avenue of the Stars, 9th Floor  
Los Angeles, California 90067  
17 [Counsel for party in interest]
- 18 J. Christopher Kohn  
Tracy J. Whitaker  
19 Brendan Collins  
Civil Division  
20 Department of Justice  
P.O. Box 875  
21 Ben Franklin Station  
Washington, D.C. 20044  
22 [Counsel for United States of America]
- 23 J. Christopher Kohn  
Tracy J. Whitaker  
24 Brendan Collins  
Department of Justice  
25 1100 L Street, N.W. Room 10004  
Washington, D.C. 20005  
26 [Counsel for United States of America]
- 27
- 28
- J. Matthew Derstein  
Roshka Heyman & DeWulf PLC  
Two Arizona Center  
400 North 5th Street, Suite 1000  
Phoenix, AZ 85004  
[Counsel for Tucson Electric Power Company]
- James E. Till, Esq.  
Perkins Coie LLP  
1211 SW Fifth Ave., Suite 1500  
Portland, OR 97204  
[Counsel for Bank of Montreal]
- James R. Thompson  
Idaho Power Company  
1221 W. Idaho Street  
Boise, Idaho 83702
- Jeffrey M. Wilson  
Saybrook Capital LLC  
303 Twin Dolphin Drive, Suite 600  
Redwood City, California 94065  
[Proposed Investment Banker to Committee]
- Jeffry A. Davis  
Gray Cary Ware & Freidenrich LLP  
401 B Street, Suite 1700  
San Diego, California 92101  
[Counsel for International Brotherhood of Electrical Workers, Local 47 and Local 1245]
- JoAnn P. Russell  
Duke Energy Trading and Marketing LLC  
10777 Westheimer, Suite 650  
Houston, TX 77042
- John F. Shellabarger  
Law Offices of John F. Shellabarger  
928 Garden Street, Suite 3  
Santa Barbara, California 93101  
[Counsel for Carriage Homes, Inc.]
- John G. Klaufberg  
LeBoeuf, Lamb, Greene & MacRae, LLP  
125 West 55th Street  
New York, NY 10019  
[Counsel for Enron North America Corp  
and Enron Canada Corp.]
- John P. Dillman  
Linerbarger Heard Goggan Blair  
Graham Pena & Sampson, LLP  
P.O. Box 3064  
Houston, TX 77253

- 1 John P. Melko  
Wendy K. Laubach
- 2 Verner, Liipfert, Bernhard,  
McPherson and Hand
- 3 1111 Bagby, Suite 4700  
Houston, TX 77002
- 4 [Counsel for Sacramento Municipal  
Utility District]
- 5 John T. Hansen
- 6 Deborah H. Beck
- 7 Nossaman, Guthner, Knox & Elliott  
50 California Street, 34th Floor  
San Francisco, California 94111
- 8 [Counsel for Committee of PG&E  
Retirees and Survivors]
- 9 Jonathan Rosenthal
- 10 Jon P. Schotz
- 11 Jonathan Y. Thomas
- 12 Saybrook Capital LLC  
401 Wilshire Boulevard, Suite 850  
Santa Monica, California 90401  
[Proposed Investment Banker to Committee]
- 13 Joseph A. Eisenberg, P.C.
- 14 Victoria S. Kaufman
- 15 Jeffer, Mangels, Butler & Marmaro LLP  
2121 Avenue of the Stars, Tenth Floor  
Los Angeles, CA 90067
- 16 [Counsel for California Power Exchange Corp.]
- 17 KBC Bank  
Attn: Daniel To  
515 So. Figueroa St., Suite 1920  
Los Angeles, CA 90071
- 18 Kenneth N. Russak
- 19 Pillsbury Winthrop LLP  
725 South Figueroa Street, Suite 2800  
Los Angeles, California 90017  
[Counsel for Dynergy Power Marketing, Inc.; El Segundo  
Power LLC; Long Beach Generation LLC; Cabrillo Power I  
22 LLC; Cabrillo Power II, LLC; Dynergy Marketing & Trade  
23 LLC; West Coast LLC]
- 24 Kevin K. Haah
- 25 Ervin, Cohen & Jessup LLP  
9401 Wishire Boulevard, 9th Floor  
Beverly Hills, California 90212  
[Counsel for Ronald A. Katz Technology Licensing L.P.]
- 26
- 27
- 28
- Kimberly S. Winick  
Mayer, Brown & Platt  
350 South Grand Avenue, 25th Floor  
Los Angeles, California 90071  
[Counsel for Aera Energy LLC]
- Kjehl T. Johansen  
Legal Division  
Office of City Attorney  
Department of Water and Power  
P.O. Box 51111, Suite 340  
Los Angeles, California 90051
- Larren M. Nashelsky  
Morrison & Foerster LLP  
1290 Avenue of the Americas  
New York, NY 10104  
[Counsel for El Paso Merchant Energy L.P.]
- Lillian G. Stenfeldt  
Fred Hjelmeset  
Gray Cary Ware & Freidenrich LLP  
1755 Embarcadero  
Palo Alto, California 94303  
[Counsel for International Brotherhood of Electrical Work-  
ers, Local 47 and Local 1245]
- Louise H. Renne  
City Attorney  
L. Joanne Sakai  
Theresa Mueller  
Cameron Baker  
City Hall, Room 234  
One Dr. Carlton B. Goodlett Place  
San Francisco, California 94102  
[Counsel for the City and County of San Francisco]
- M. Freddie Reiss  
PricewaterhouseCoopers LLP  
400 South Hope Street  
Los Angeles, California 90071  
[Proposed Financial Advisor to Committee]
- M.O. Sigal Jr.  
Simpson Thatcher & Bartlett  
425 Lexington Avenue  
New York, NY 10017  
[Counsel for Duke Energy Trading  
and Marketing]

- |    |   |  |
|----|---|--|
| 1  | Marc S. Cohen<br>Jeffrey A. Krieger   | Mellon Bank, N.A.<br>Attn: L. Scott Sommers<br>400 So. Hope Street, 5th Floor<br>Los Angeles, CA 90071-2806  |
| 2  | Greenberg Glusker Fields Claman<br>Machtinger & Kinsella  |  |
| 3  | 1900 Avenue of the Stars, Suite 2100<br>Los Angeles, California 90067   | Merle C. Meyers  |
| 4  | [Counsel for Official Committee of<br>Participants' Creditors Claims]   | Katherine D. Ray<br>Goldberg, Stinnett, Meyers & Davis<br>44 Montgomery Street, Suite 2900<br>San Francisco, California 94104<br>[Counsel for Modesto Irrigation District]                                     |
| 5  | Mark C. Ellenberg   |  |
| 6  | Cadwalader, Wickersham & Taft<br>1201 F Street N.W., Suite 1100<br>Washington, D.C. 20004<br>[Counsel for MBIA]   | Merrill Lynch<br>Attn: Ahi Aharon<br>World Financial Ctr., North Tower<br>250 Vesey Street, 10th Floor<br>New York, NY 10281-1310  |
| 8  | Mark Finnemore  |  |
| 9  | Internal Revenue Service<br>Small Business/Self-Employed Division Counsel   |  |
| 10 | 160 Spear Street, 9th Floor<br>San Francisco, California 94105  | Michael A. Rosenthal<br>Keith D. Ross<br>Gibson Dunn & Crutcher LLP<br>2100 McKinney Avenue, Suite 1100<br>Dallas, TX 75201<br>[Counsel for NRG Energy, Inc.]  |
| 11 | [Counsel for the United States of America]  |  |
| 12 | Mark Hirschfield<br>Benjamine Hoch  |  |
| 13 | Dewey Ballantine LLP<br>1301 Avenue of the Americas<br>New York, New York 10019-6092  | Michael E. Ross<br>AES New Energy, Inc.<br>350 South Grand Avenue, Suite 2950<br>Los Angeles, California 90017   |
| 14 | Mark P. Weitzel<br>Paul C. Lacourciere  |  |
| 15 | Thelen, Reid & Priest LLP<br>101 Second Street, Suite 1800<br>San Francisco, California 94105<br>[Counsel for Bruney Forest Products]   | Michael F. O'Friel<br>Wheelabrator Technologies, Inc.<br>4 Liberty Lane West<br>Hampton, NH 03842  |
| 16 |   |  |
| 17 | Martha E. Romero<br>Law Offices of Martha E. Romero<br>7743 South Painter Avenue, Suite A<br>Whittier, California 90602<br>[Counsel for Secured Creditors Various California Counties<br>in California] | Michael Friedman<br>Richard Spears Kibbe & Orbe<br>One Chase Manhattan Plaza<br>New York, NY 10005<br>[Counsel for DK Acquisition Partners]  |
| 18 |   |  |
| 19 | Martin L. Fineman<br>David Wright Tremaine LLP<br>One Embarcadero Center, Suite 600<br>San Francisco, California 94111<br>[Counsel for Wheelabrator Shasta Energy Co.]                                  | Michael Hamilton<br>PricewaterhouseCoopers LLP<br>1301 Avenue of the Americas<br>New York, NY 10019<br>[Proposed Financial Advisor to Committee]   |
| 20 |   |  |
| 21 | MBIA Insurance Corporation<br>Attn: IPM-PCF<br>113 King Street<br>Armonk, NY 10504  | Michael L. Tuchin<br>David M. Stern<br>Klee, Tuchin, Bogdanoff & Stern LLP<br>1880 Century Park East, Suite 200<br>Los Angeles, California 90067<br>[Counsel for Caithness Energy, LLC and<br>FPL Energy Inc.] |
| 22 |   |  |
| 23 |   |  |
| 24 |   |  |
| 25 |   |  |
| 26 |   |  |
| 27 |   |  |
| 28 |   |  |

1 Michael Morris  
 Hennigan, Bennet & Dorman  
 2 601 South Figueroa Street, Suite 3300  
 Los Angeles, California 90017  
 3 [Counsel for Southern California Gas Company]

4 Mike R. Jaske  
 California Energy Commission  
 5 1516 Ninth Street, MS-22  
 Sacramento, California 95814

6 Mitchell I. Sonkin  
 7 Cadwalader, Wickersham & Taft  
 100 Maiden Lane  
 8 New York, NY 10038  
 [Counsel for MBIA]

9 Morgan Guaranty Trust Company of New York  
 10 Attn: Carl J. Mehldau  
 60 Wall Street  
 11 New York, NY 10260

12 Mr. David Boergers, Secretary  
 Federal Energy Regulatory Commission  
 13 888 First Street, N.E., Room 1-A  
 Washington, DC 20246

14 Nanette D. Sanders  
 15 Sarah E. Petty  
 Snell & Wilmer LLP  
 16 1920 Main Street, Suite 1200  
 Irvine, California 92614  
 17 [Counsel for Arizona Public Service Co.]

18 Office of the U.S. Trustee  
 Attn: Stephen Johnson  
 19 250 Montgomery Street, Suite 1000  
 San Francisco, CA 94104-3401

20 PanCanadian Energy Services Inc.  
 21 Attn: Brian Redd  
 1200 Smith Street, Suite 900  
 22 Houston, TX 77002

23 Patricia S. Mar  
 Morrison & Foerster LLP  
 24 425 Market Street, 33rd Floor  
 San Francisco, CA 94105-2482  
 25 E-mail: pmar@mof.com  
 [Counsel for AES New Energy, Inc.]

Patricia S. Mar, Esq.  
 Morrison & Foerster LLP  
 425 Market Street, 33rd Floor  
 San Francisco, CA 94105-2482  
 [Counsel for Avista Energy, Inc. and  
 GWF Power Systems Company, Inc.]

Peter J. Benvenuto  
 Heller Ehrman White & McAuliffe LLP  
 333 Bush Street  
 San Francisco, California 94104

Philip Warden  
 Pillsbury, Winthrop LLP  
 50 Fremont Street  
 San Francisco, California 94105  
 [Counsel for Southern California Gas Company]

Phillip S. Warden  
 Pillsbury Winthrop LLP  
 50 Fremont Street  
 San Francisco, California 94105  
 [Counsel for Dynergy Power Marketing, Inc.; El Segundo  
 Power LLC; Long Beach Generation LLC; Cabrillo Power I  
 LLC; Cabrillo Power II, LLC; Dynergy Marketing & Trade  
 LLC; West Coast LLC]

Pillsbury Winthrop LLP  
 Attn: Kenneth N. Russak, Esq.  
 725 S. Figueroa Street, Suite 2800  
 Los Angeles, CA 90017-5406  
 [Counsel to Parties in Interest: Dynergy Power Marketing,  
 Inc., El Segundo Power LLC, Long Beach Generation LLC,  
 Cabrillo Power I LLC, Cabrillo Power II, LLC, Dynergy  
 Marketing & Trade LLC and West Coast Power, LLC]

R. Dale Ginter  
 Downey, Brand, Seymour & Rohwer LLP  
 555 Capitol Mall, 10th Floor  
 Sacramento, California 95814  
 [Counsel for Merced Irrigation District, Occidental of Elk  
 Hills, Diamond Walnut Growers, and Hertz Corporation]

Rabobank Nederland  
 Attn: Tamira Treffers-Herrera  
 Three Embarcadero Center  
 Suite 930  
 San Francisco, CA 94111

Rabobank Nederland  
 New York Branch  
 Attn: International Trade Services  
 245 Park Avenue  
 New York, NY 10167-0062

- |    |   |   |
|----|---|---|
| 1  | Randy E. Michelson<br>McCutchen, Doyle, Brown & Enersen, LLP<br>Three Embarcadero Center<br>San Francisco, California 94111<br>[Counsel for Reliant Energy, Inc.]   | Richard W. Esterkin<br>Morgan, Lewis & Bockius LLP<br>300 South Grand Avenue<br>Los Angeles, California 90071<br>[Counsel for Fuji Bank, Limited]   |
| 2  |   |   |
| 3  |   |   |
| 4  | Region IV<br>U.S. Nuclear Regulatory Commission<br>Ellis W. Mershoff<br>Regional Administrator<br>611 Ryan Plaza Drive, suite 400<br>Arlington, TX 76011-8064   | Richard Wyron<br>Swidler Berlin Shereff Friedman LLP<br>3000 K Street, NW, Suite 300<br>Washington, DC 20007<br>[Attorney for California Independent System Operator]   |
| 5  |   |   |
| 6  |   |   |
| 7  |   |   |
| 8  | Richard A. Lapping<br>Louis J. Cisz, III<br>Thelen Reid & Priest LLP<br>101 Second Street, Suite 1800<br>San Francisco, CA 94105-3601<br>[Counsel for Creditor, Calpine Corporation<br>and its Affiliated Entities] | Robert A. Greenfield, Esq.<br>Stutman, Treister & Glatt<br>3699 Wilshire Blvd., #900<br>Los Angeles, CA 90010-2766  |
| 9  |   |   |
| 10 |   |   |
| 11 |   |   |
| 12 | Richard Blackstone Webber II<br>Richard Blackstone Webber II, P.A.<br>2507 Edgewater Drive<br>2507 Edgewater Drive<br>Orlando, FL 32804<br>[Counsel for Blue Cross and Blue Shield of<br>Florida, Inc.]             | Robert Darby<br>Corestaff Services (California), Inc.<br>Fulbright & Jaworski LLP<br>865 South Figueroa, 29th Floor<br>Los Angeles, California 90017<br>[Counsel for Corestaff Services (California), Inc.]                                   |
| 13 |   |   |
| 14 |   |   |
| 15 |   |   |
| 16 | Richard C. Josephson<br>Stoel Rives LLP<br>900 SW Fifth Avenue, Suite 2600<br>Portland, OR 97204<br>[Counsel for PacifiCorp and Crockett Cogen]   | Robert E. Izmirian<br>Aaron M. Oliner<br>Buchalter, Nemer, Fields & Younger<br>333 Market Street<br>San Francisco, California 94105<br>[Counsel for MBIA]   |
| 17 |   |   |
| 18 |   |   |
| 19 | Richard Hopp<br>14416 Victory Boulevard, Suite 108<br>Van Nuys, California 91401<br>[Richard Hopp in Propria Persona]   | Robert Jay Moore<br>Paul S. Aronzon<br>Milbank, Tweed, Hadley & McCloy LLP<br>601 South Figueroa Street<br>Los Angeles, California 90017<br>[Counsel for Official Committee of Unsecured Creditors]   |
| 20 |   |   |
| 21 | Richard Purcell<br>Conectiv<br>252 Chapman Road<br>Christiana Building<br>Newark, Delaware 19702  | Robert M. Blum<br>Thelen Reid & Priest LLP<br>101 Second Street, Suite 1800<br>San Francisco, California 94105<br>[Counsel for Davey Tree Surgery Company]  |
| 22 |   |   |
| 23 |   |   |
| 24 | Richard Stevens<br>Avista Corp.<br>P.O. Box 3727<br>Spokane, WA 99220   | Robert S. Mueller, III<br>United States Attorney<br>Jocelyn Burton<br>Assistant United States Attorney<br>Douglas K. Chang<br>450 Golden Gate Avenue, 10th Floor<br>San Francisco, California 94102<br>[Counsel for United States of America] |
| 25 |   |   |
| 26 |   |   |
| 27 |   |   |
| 28 |   |   |

- |    |   |  |  |
|----|---|--|--|
| 1  | Robert S. Mueller, III<br>United States Attorney                              |  | Seth A. Ribner<br>Simpson Thatcher & Bartlett  |
| 2  | Jay R. Weill<br>Assistant United States Attorney                              |  | 10 Universal City Plaza, Suite 1850<br>Universal City, California 91608  |
| 3  | Thomas MacKinson<br>160 Spear Street, Ninth Floor                             |  | [Counsel for Duke Energy Trading and Marketing]  |
| 4  | San Francisco, California 94105<br>[Counsel for the United States of America] |  |  |
| 5  | Roi Chandy<br>Teachers Insurance and Annuity Assoc. of America                |  | Sharyn B. Zuch<br>Wiggin & Dana  |
| 6  | 730 Third Avenue<br>New York, NY 10017  |  | One CityPlace, 34th Floor<br>185 Asylum Street<br>Hartford, CT 06103<br>[Counsel for American Payment Systems]                 |
| 7  | Roland Pfeifer<br>Office of the City Attorney                                 |  | Sierra Pacific Industries<br>File #51950   |
| 8  | 1500 Warburton Avenue<br>Santa Clara, California 95050                        |  | San Francisco, California 94160  |
| 9  | Rosanne Thomas Matzat<br>Hahn & Hessen LLP                                    |  | Southern California Gas Company<br>Attn: Jim Nakata  |
| 10 | 350 Fifth Avenue, Suite 3700<br>New York, NY 10118                            |  | 555 W. Fifth St., GT24E1<br>Los Angeles, CA 90013-1000   |
| 11 | [Counsel for Metropolitan Life Insurance Co.]                                 |  | State of California EDD<br>P.O. Box 826880<br>Sacramento, CA 94280   |
| 12 | Scott O. Smith<br>Buchalter, Nemer, Fields & Younger                          |  | State of California<br>Dept. of Water Resources<br>c/o Chief – Energy Division   |
| 13 | 601 South Figueroa Street, Suite 2400<br>Los Angeles, California 90017        |  | Attn: Dan Herdocia<br>1416 9th Street, Room 1640<br>Sacramento, CA 95814   |
| 14 | [Counsel for Quanta Services, Inc.]   |  | State of California<br>Office of the Attorney General<br>455 Golden Gate Avenue<br>Suite 11000<br>San Francisco, CA 94102-3664 |
| 15 | Secretary of Treasury<br>15th & Pennsylvania Avenue<br>Washington, D.C. 20549 |  | State of California<br>Office of the Attorney General<br>PO Box 94255<br>Sacramento, CA 94244-2550                             |
| 16 | Securities Exchange Commission<br>Attn: Sandra W. Lavigna                     |  | State of California<br>Office of the Attorney General<br>PO Box 94255<br>Sacramento, CA 94244-2550                             |
| 17 | 1416 9th Street, Room 1640<br>Sacramento, CA 95814                            |  | State of California<br>Office of the Attorney General<br>PO Box 94255<br>Sacramento, CA 94244-2550                             |
| 18 | Securities Exchange Commission<br>Attn: Sandra W. Lavigna                     |  | State of California<br>Office of the Attorney General<br>PO Box 94255<br>Sacramento, CA 94244-2550                             |
| 19 | 5670 Wilshire Blvd., 11th Fl.<br>Los Angeles, CA 90036                        |  | State of California<br>Office of the Attorney General<br>PO Box 94255<br>Sacramento, CA 94244-2550                             |
| 20 | Los Angeles, CA 90036   |  | State of California<br>Office of the Attorney General<br>PO Box 94255<br>Sacramento, CA 94244-2550                             |
| 21 | Sempra Energy Trading Corp.<br>Tony Ferrajina                                 |  | Stephanie Nolan Deviney<br>Brown & Connery LLP   |
| 22 | 58 Commerce Drive<br>Stamford, CT 06902                                       |  | 360 Haddon Avenue<br>P.O. Box 539<br>Westmont, NJ 08108<br>[Counsel for SAP America, Inc.]                                     |
| 23 |   |  |  |
| 24 |   |  |  |
| 25 |   |  |  |
| 26 |   |  |  |
| 27 |   |  |  |
| 28 |   |  |  |

1 Steve G. F. Polard  
Perkins Coie LLP  
2 1620-26th Street, Sixth Floor  
Santa Monica, California 90404  
3 [Counsel for Creditor Puget Sound Energy, Inc.]

4 Steve J. Reisman  
Curtis, Mallet-Prevost, Colt & Mosle LLP  
5 101 Park Avenue  
New York, NY 10178

6 Steven H. Felderstein, Esq.  
7 Felderstein, Willoughby & Pascuzzi  
400 Capital Mall, Suite 1450  
8 Sacramento, CA 95814-4434  
[Attorney for State of California]

9 Texaco Canada Petroleum Inc.  
10 Attn: Bill Collier  
2035 400 3rd Avenue, S.W.  
11 Calgary, Alberta  
Canada T2P 4H2

12 Texaco Natural Gas Inc.  
13 Attn: Bill Collier  
1111 Bagby Street  
14 Houston, Texas 77002

15 The Bank of New York  
Attn: Michael Pitflick  
16 Corporate Trust Administration  
101 Barclay Street - 21W  
17 New York, NY 10286

18 The Fuji Bank, Limited  
Attn: Jonathan Bigelow  
19 333 So. Hope Street, 39th Floor  
Los Angeles, CA 90071

20 The Sumitomo Bank Ltd.  
21 Attn: Al Galluzzo  
777 S. Figueroa St., Suite 2600  
22 Los Angeles, CA 90017-3138

23 The Toronto Dominion Bank  
Attn: F.B. Hawley  
24 909 Fannin, Suite 1700  
Houston, TX 77010

25 Thomas B. Walper, Esq.  
26 Munger, Tolles & Olson LLP  
355 South Grand Ave., Suite 3500  
27 Los Angeles, CA 90071-1560  
[Counsel for Southern California Edison]

Thomas C. Walsh  
BTM Capital Corporation  
125 Summer Street  
Boston, MA 02110

Thomas E. Lumsden  
PricewaterhouseCoopers LLP  
199 Fremont Street  
San Francisco, California 94105  
[Proposed Financial Advisor to Committee]

Thomas MacKinson  
Internal Revenue Service  
Small Business/Self-Employed Division  
1301 Clay Street, Room 1400-S  
Oakland, California 94105  
[Counsel for the United States of America]

Timothy F. Hodgdon  
Teachers Insurance and Annuity Assoc. of America  
730 Third Avenue  
New York, NY 10017

TJ Vigliotta  
Lazard Frères & Co. LLC  
30 Rockefeller Plaza, 60th Floor  
New York, NY 10020

TXU Energy Trading Canada Limited  
Attn: Jeff Shorter  
1717 Main Street  
Dallas, Texas 75201

TXU Energy Trading Company  
Attn: Jim Macredie  
1717 Main Street  
Dallas, Texas 75201

U.S. Bank  
Corporate Trust Services  
Attn: LaDonna Morrison  
180 East Fifth St., 3rd Floor  
St. Paul, MN 55170

U.S. Nuclear Regulatory Commission  
Attn: Document Control Desk  
Washington, DC 20555-0001

U.S. Trust Company, National Association  
Attn: Josephine Libunao  
One Embarcadero Center, Suite 2050  
San Francisco, CA 94111-3709

- |    |   |   |
|----|---|---|
| 1  | Union Bank of Switzerland<br>New York Branch<br>Attn: Paul Morrison<br>299 Park Avenue<br>New York, NY 10171  | William M. Rossi-Hawkins<br>Phillips, Lytle, Hitchcock, Blaine & Huber<br>437 Madison Avenue, 34th Floor<br>New York, NY 10022<br>[Counsel for HSBC Bank USA]           |
| 4  | US Bank, Corporate Trust Services<br>Ladonna Morrison<br>P.O. Box 64111<br>St. Paul, MN 55164-0111  | William P. Weintraub<br>Pachulski Stang Ziehl Young & Jones<br>Three Embarcadero Center, Suite 1020<br>San Francisco, California 94111<br>[Counsel for PG&E Corp.]      |
| 7  | Victoria Lang<br>AT&T Corp.<br>795 Folsom Street, 2nd Floor<br>San Francisco, California 94107<br>[Counsel for AT&T Corp]   | Williams Energy Marketing & Trading Co.<br>Attn: Kelly Knowlton<br>One Williams Center, 19th Floor<br>Department 558<br>P.O. Box 2848<br>Tulsa, Oklahoma 74172          |
| 9  | Wheelabrator Shasta Energy Co. Inc.<br>20811 Industry Rd.<br>Anderson, CA 96007   | Williams Energy Marketing & Trading Co. (Canada)<br>Attn: Kelly Knowlton<br>One Williams Center, 19th Floor<br>Department 558<br>P.O. Box 2848<br>Tulsa, Oklahoma 74101 |
| 11 | White & Case, LLP<br>Attn: Neil Millard<br>633 West Fifth St., Suite 1900<br>Los Angeles, CA 90071-2007<br>[Attorney for BNY Western Trust Company]                     | Zack Starbird<br>Mirant Corporation<br>1155 Perimeter Center West<br>Atlanta, GA 30338  |
| 14 | White & Case, LLP<br>Attn: Neil Millard/C. Randolph Fishburn<br>633 West Fifth St., Suite 1900<br>Los Angeles, CA 90071-2007<br>[Attorney for Bank of New York]         | Thomas C. Walsh<br>BTM Capital Corporation<br>125 Summer Street<br>Boston, MA 02110   |
| 17 | William Bates, III<br>McCutchen, Doyle, Brown & Enersen, LLP<br>3150 Porter Drive<br>Palo Alto, California 94304<br>[Counsel for Reliant Energy, Inc.]                  | Daren R. Brinkman<br>Brinkman & Associates<br>800 Wilshire Boulevard, Suite 950<br>Los Angeles, California 90017<br>[Counsel for TransAlta Energy]                      |
| 21 | William H. Kiekhofer, III<br>Kelley Drye & Warren LLP<br>777 South Figueroa Street, Suite 2700<br>Los Angeles, CA 90017<br>[Counsel for BP Energy Company]              | Steven M. Abramowitz<br>Vinson & Elkins LLP<br>666 Fifth Avenue, 26th Floor<br>New York, NY 10103<br>[Counsel for TransAlta Energy]                                     |
| 23 | William J. Flynn<br>Neyhart, Anderson, Freitas, Flynn & Grosboll<br>600 Harrison Street, Suite 535<br>San Francisco, California 94107<br>[Counsel for IBEW Local #1245] | Sertling Koch<br>TransAlta Energy Marketing (U.S.) Inc.<br>Box 1900 Station "M"<br>110-12th Avenue, SW<br>Calgary, Alberta T2P 2MI                                      |

SHROCK & SHROCK & LAVAN LLP  
 MEMBERSHIP IN  
 2029 C ENERGY PARK I ST., SUITE 1800  
 LOS ANGELES, CALIFORNIA 90067-4086  
 PHOENIX (303) 576-5800

1 Jennifer A. Merlo  
Bradley E. Pearce  
2 Moore & Van Allen, PLLC  
Bank of America Corporation Center  
3 100 North Tryon Street, Floor 47  
Charlotte, North Carolina 28202

4 Aaron M. Oliner  
5 Buchalter, Nemer, Fields & Younger  
333 Market Street  
6 San Francisco, California 94105  
[Counsel for CSAA]

7 Eric A. Nyberg  
8 Charles D. Novack  
Kornfield, Paul & Nyberg, P.C.  
9 1999 Harrison Street, Suite 800  
Oakland, California 94612  
10 [Counsel for KB Home]

11 Wendy L. Hagenau  
Powell, Goldstein, Frazer & Murphy  
12 16th Floor  
191 Peachtree Street, N.E.  
13 Atlanta, GA 30303  
[Counsel for Intecom Inc.]

14 George O'Brien  
15 Vice President and Treasurer  
Intecom, Inc.  
16 5057 Keller Springs Road  
Addison, Texas 75001

17 Julia Hill, County Counsel  
18 County of Santa Cruz  
Office of the Treasurer - Tax Collector  
19 701 Ocean Street, Room 505  
Santa Cruz, California 95060  
20 [Counsel for County of Santa Cruz]

21 Douglas P. Bartner  
Andrew Tenzer  
22 Shearman & Sterling  
599 Lexington Avenue  
23 New York, NY 10022  
[Counsel for Citibank, N.A.]

24 Amy Hallman Rice  
25 Dorsey & Whitney LLP  
Pillsbury Center South  
26 220 South Sixth Street  
Minneapolis, Minnesota 5540-1498  
27 [Counsel for U.S. Bank Trust National Association]

28

Peter J. Gurfein, Esq.  
Jeffrey C. Krause, Esq.  
Gregory K. Jones, Esq.  
Akin, Gump, Strauss, Hauer & Feld, L.L.P.  
2029 Century Park East, Suite 2600  
Los Angeles, CA 90068

Mark Gorton, Esq.  
McDonough, Holland & Allen  
555 Capitol Mall, 9<sup>th</sup> Floor  
Sacramento, CA 95814

David Gould, Esq  
McDermott, Will & Emery  
2049 Century Park East, 34<sup>th</sup> Floor  
Los Angeles, CA 90067

Carla Batchler  
Trust Department  
Bank of Cherry Creek  
3033 East 1st Avenue  
Denver, CO 80206

Neil J. Rubenstein  
Holly R. Shilliday  
Arter & Hadden LLP  
Two Embarcadero Center, 5<sup>th</sup> Floor  
San Francisco, CA 94111

Marc Barreca  
John R. Knall, Jr.  
Preston Gates & Ellis LLP  
701 Fifth Avenue, Suite 5000  
Seattle, WA 98104

Janine D. Bloch  
Preston Gates & Ellis LLP  
One Maritime Plaza, Suite 2400  
San Francisco, CA 94111

Lawrence M. Jacobson  
Baker and Jacobson  
11377 West Olympic Boulevard, Suite 500  
Los Angeles, CA 90064

Samuel Jackson, City Attorney  
Office of the City Attorney, City of Sacramento  
Robert D. Takunaga, Deputy City Attorney  
980 Ninth Street, Tenth Floor  
Sacramento, CA 95814

- 1 Robert D. Albergotti  
Stacey Jernigan
- 2 Scott W. Everett  
Haynes and Boone LLP
- 3 901 Main Street, Suite 3100  
Dallas, Texas 75202
- 4 Paul M. Bartkiewicz  
Joshua M. Horowitz
- 5 Bartkiewicz, Kronick & Shanahan  
1011 Twenty Second Street
- 6 Sacramento, CA 95816
- 7 Juan C. Basombrio  
Kent J. Schmidt
- 8 Dorsey & Whitney LLP  
650 Town Center Drive, Suite 1850
- 9 Costa Mesa, CA 92626
- 10 Estela O. Pino  
Cynthia E. Chisum
- 11 Pino & Associates  
1260 Fulton Avenue
- 12 Sacramento, CA 95825
- 13 Dale W. Mahon  
9951 Grant Line Road
- 14 Elk Grove, CA 95624
- 15 Martin A. Martino  
Castle Companies
- 16 12885 Alcosta Boulevard, Suite A  
San Ramon, California 94583
- 17 Michael B. Lubic  
McCutchen Doyle Brown & Enersen LLP
- 18 355 South Grand Avenue, Suite 4400  
Los Angeles, CA 90071
- 19 Stanley E. Pond  
Winchell & Pond
- 20 1700 South El Camino Real, Suite 506  
San Mateo, CA 94402
- 21 Cahal B. Carmody  
Bank of Montreal
- 22 4400 Nations Bank Building  
700 Louisiana Street
- 23 Houston, TX 77002
- 24
- 25
- 26
- 27
- 28

- Lynne Richardson  
Air Products and Chemicals Inc.  
Business Services A6328  
7201 Hamilton Boulevard  
Allentown, PA 18195
- Karen Keating Jahr, County Counsel  
Michael A. Ralston, Assistant County Counsel  
1815 Yuba Street, Suite 3  
Redding, California 96001
- Lori J. Scott  
Shasta County Treasurer - Tax Collector  
P.O. Box 991830  
Redding, California 96099
- Bill Wong  
AMROC Investments, LLC  
535 Madison Avenue, 15<sup>th</sup> Floor  
New York, NY 10022
- Stephen Shane Stark, County Counsel  
Enrique R. Sanchez, Sr.  
County of Santa Barbara  
105 E. Anapamu Street, Suite 201  
Santa Barbara, CA 93101
- Nancy Newman  
Steinhart & Falconer LLP  
333 Market Street, 32<sup>nd</sup> Floor  
San Francisco, CA 94105
- James S. Monroe  
Lillick & Charles LLP  
Two Embarcadero Center, Suite 2700  
San Francisco, CA 94111
- Daniel M. Pelliccioni  
Julia W. Brand  
Katten Muchin Zavis  
1999 Avenue of the Stars, Suite 1400  
Los Angeles, CA 90067
- John Robert Weiss  
Katten Muchin Zavis  
525 West Monroe Street, Suite 1600  
Chicago, IL 60661
- Marimargaret Webdell  
Sacramento County Department of Finance  
700 H. Street, Room 1710  
Sacramento, CA 95814

1	M. David Minnick Pillsbury Winthrop LLP 50 Fremont Street San Francisco, CA 94105	John Chu Corporate Counsel Law Group LLP 417 Montgomery Street, 10 <sup>th</sup> Floor San Francisco, CA 94104
2		
3	Arnold Wallenstein ThermoEcotek Corporation 245 Winter Street, Suite 300 Waltham, MA 02154	Peter R. Boutin Keesal, Young & Logan Four Embarcadero Center, Suite 1500 San Francisco, CA 94111
4		
5		
6	Martin Marz BP Amoco P.O. Box 3092 Houston, TX 77079	Ralph B. Levy James A. Pardo, Jr. Brian C. Walsh Jeffrey E. Bjork King & Spalding 191 Peachtree Street Atlanta, GA 30303
7		
8	Peter S. Clark II Derek J. Baker Reed Smith, LLP 2500 Liberty Place 1650 Market Street Philadelphia, PA 19103-7301	Tony O. Hemming Texaco Legal Department 1111 Bagby Street Houston, Texas 77002
9		
10		
11		
12	Kelly Greene McConnell Givens Pursley LLP 277 North 6 <sup>th</sup> Street, Suite 200 Boise, ID 83702	Mairi V. Luce Duane Morris & Heckscher LLP 4200 One Liberty Place Philadelphia, PA 19103
13		
14	Rock S. Koebbe 5356 North Cattail Way Boise, ID 83703	
15		
16	Mary B. Holland Financial Consultant Salomon Smith Barney 1111 Superior Avenue, Suite 1800 Cleveland, OH 44114-2507	Thomas M. Berliner Duane Morris & Heckscher LLP 100 Spear Street, Suite 1500 San Francisco, CA 94105
17		
18		
19	Roger L. Efremsky Austin P. Nagel Law Offices of Efremsky & Nagel 5776 Stoneridge Mall Road, Suite 360 Pleasanton, CA 94588	Madison S. Spach, Jr. Spach & Associates, P.C. 4675 MacArthur Court, Suite 550 Newport Beach, CA 92660
20		
21		
22	Stan T. Yamamoto Eileen M. Teichert City of Riverside City Attorney's Office City Hall, 3900 Main Street Riverside, CA 92522	Michael Rochman School Project for Utility Rate Reduction 1430 Willow Pass Road, Suite 240 Concord, CA 94520
23		
24		
25		
26	Howard Susman Duckor Spralding & Metzger 401 West A Street, Suite 2400 San Diego, CA 92101	Sheryl Gussett Reliant Energy, Inc. 1111 Louisiana, 43 <sup>rd</sup> Floor Houston, TX 77002
27		
28		
		Paul J. Pantano, Jr. McDermott, Will & Emery 600 13 <sup>th</sup> Street, N.W. Washington, D.C. 20005

- |    |  |   |
|----|--|---|
| 1  | Gregory Clore<br>Gnazzothill, A.P.C.<br>625 Market Street, Suite 1100<br>San Francisco, CA 94105   | David Boies<br>Christopher A. Boies<br>Philip C. Korologos<br>Boies, Schiller & Flexner LLP<br>80 Business Park Drive, Suite 110<br>Armonk, New York 10504                          |
| 2  |  |   |
| 3  | Bruce W. Leaverton   |   |
| 4  | Mary Jo Heston<br>Lane Powell Spears Lubersky LLP<br>1420 Fifth Avenue, Suite 4100<br>Seattle, WA 98101  | David S. MacCuish<br>Andrew M. Gilford<br>Kara Hatfield<br>Weston, Benshoof, Rochefort<br>444 South Flower Street, Forty Third Floor<br>Los Angeles, CA 90071                       |
| 5  |  |   |
| 6  | Marilyn Morris   |   |
| 7  | Kenneth M. Miller<br>Morgan, Miller & Blair<br>1676 N. California Blvd., Suite 200<br>Walnut Creek, CA 94596   | Kenneth N. Klee<br>David M. Stern<br>Michael L. Tuchin<br>Michelle C. Campbell<br>Klee, Tuchin, Bogdanoff & Stern LLP<br>1880 Century Park East, Suite 200<br>Los Angeles, CA 90067 |
| 8  |  |   |
| 9  | Angela M. Alioto   |   |
| 10 | Law Offices of Joseph L. Alioto and Angela Alioto<br>700 Montgomery Street<br>San Francisco, CA 94111  |   |
| 11 |  |   |
| 12 | Jody A. Meisel<br>2632 Larkin Street, Suite 0<br>San Francisco, CA 94109   | Irving Sulmeyer<br>Victor A. Sahn<br>Frank V. Zerunyan<br>Sulmeyer, Kupetz, Baumann & Rothman<br>300 South Grand Avenue, 14 <sup>th</sup> Floor<br>Los Angeles, CA 90071            |
| 13 |  |   |
| 14 | Terrance L. Stinnett<br>Miriam Khatiblou<br>Goldberg, Stinnett, Meyers & Davis<br>44 Montgomery Street, Suite 2900<br>San Francisco, CA 94014            | David H. Ford<br>David Kovner<br>OZ Management LLC<br>9 West 57 <sup>th</sup> Street, 39 <sup>th</sup> Floor<br>New York, NY 10019  |
| 15 |  |   |
| 16 | Melanie Fannin<br>General Counsel<br>Senior Vice President & Secretary<br>Pacific Telesis Group<br>2600 Camino Ramon, Room 4CS100<br>San Ramon, CA 94583 | Daniel A. DeMarco<br>David T. Graham<br>Hahn, Loeser & Parks LLP<br>21 East State Street, Suite 1050<br>Columbus, Ohio 43215  |
| 17 |  |   |
| 18 | Isabelle M. Salgado<br>General Attorney<br>Pacific Telesis Group<br>2600 Camino Ramon, Room 4CS100<br>San Ramon, CA 94583                                | Thomas E. Lauria<br>Jerry R. Bloom<br>Brian L. Holman<br>White & Case LLP<br>633 West Fifth Street, 19 <sup>th</sup> Floor<br>Los Angeles, CA 90071                                 |
| 19 |  |   |
| 20 | Michael A. Berman<br>Securities and Exchange Commission<br>450 Fifth Street, N.W. (Mail Stop 0606)<br>Washington, D.C. 20549                             | J. Christopher Shore<br>White & Case LLP<br>1155 Avenue of the Americans<br>New York, NY 10036  |
| 21 |  |   |
| 22 |  |   |
| 23 |  |   |
| 24 |  |   |
| 25 |  |   |
| 26 |  |   |
| 27 |  |   |
| 28 |  |   |

- 1 Peter S. Munoz  
Gregory M. Ficks
- 2 Crosby, Heafy, Roach & May  
Two Embarcadero Center  
San Francisco, CA 94111
- 3
- 4 Scott C. Clarkson  
Eve A. Marsella
- 5 Clarkson, Gore & Marsella  
3424 Carson Street, Suite 350  
Torrance, CA 90503
- 6
- 7 James E. Spiotto  
Ann Acker
- 8 Chapman & Culter  
111 W. Monroe Street  
Chicago, IL 60603
- 9
- 10 Stephen C. Becker  
Becker Law Office  
P.O. Box 192991  
San Francisco, CA 94119
- 11
- 12 Diane C. McKenzie  
Office of the Treasurer and Tax Collector  
County of San Bernardino  
172 N. Third Street, 1st Floor  
San Bernardino, CA 92415
- 13
- 14
- 15 Ivan L. Kallick  
Manatt, Phelps & Phillips, LLP  
11355 West Olympic Boulevard  
Los Angeles, CA 90064
- 16
- 17
- 18 Gas Association of Supplies and Producers  
1112 "I" Street, Suite 350  
Sacramento, CA 95814
- 19
- 20 R. Paul Yetter  
Yetter & Warden, L.L.P.  
600 Travis, Suite 3800  
Houston, Texas 77002
- 21
- 22
- 23
- 24
- 25
- 26
- 27
- 28