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7 PACIFIC GAS AND ELECTRIC COMPANY

8 UNITED STATES BANKRUPTCY COURT  
9 NORTHERN DISTRICT OF CALIFORNIA  
10 SAN FRANCISCO DIVISION

12 In re

Case No. 01-30923 DM

13 PACIFIC GAS AND ELECTRIC  
COMPANY, a California corporation,

Chapter 11

HEARING

14 Debtor.

Date: July 24, 2001

Time: 9:30 a.m.

Place: 235 Pine Street, 22nd Floor  
San Francisco, California

16 Federal I.D. No. 94-0742640

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19 DEBTOR'S NOTICE OF MOTION AND MOTION FOR ORDER  
20 AUTHORIZING INCURRENCE OF POST-PETITION SECURED DEBT  
TO ADDITIONAL GAS SUPPLIERS UNDER PREVIOUSLY APPROVED  
21 GAS SUPPLIER SECURITY AGREEMENT; MEMORANDUM OF  
POINTS AND AUTHORITIES IN SUPPORT THEREOF

22 [SUPPORTING DECLARATION OF KENT M. HARVEY FILED SEPARATELY]  
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27 Add: ~~RIP~~  
Kids Ogc Mail Center

28 A001

DEBTOR'S MOTION FOR INCURRENCE OF POST-PETITION SECURED DEBT TO GAS SUPPLIERS

1                   **PLEASE TAKE NOTICE** that on July 24, 2001, at 9:30 a.m., or as soon  
2 thereafter as the matter may be heard, in the Courtroom of the Honorable Dennis Montali,  
3 located at 235 Pine Street, 22nd Floor, San Francisco, California, Pacific Gas and Electric  
4 Company, the debtor and debtor in possession in the above-captioned Chapter 11 case  
5 (“PG&E” or the “Debtor”), will and hereby does move the Court (the “Motion”), for an  
6 order pursuant to Bankruptcy Code Section 364 (11 U.S.C. §364) authorizing PG&E to incur  
7 post-petition secured debt in favor of additional suppliers (collectively, the “Additional  
8 Suppliers”) that sell gas on credit to PG&E, pursuant to the provisions of an existing gas  
9 supplier security agreement (the “Gas Supplier Security Agreement”) between PG&E and  
10 certain suppliers (collectively, the “Existing Suppliers”),<sup>1</sup> previously approved by the Court.

11                   The Motion is based on this Notice of Motion and Motion and the Memorandum  
12 of Points and Authorities set forth below, the supporting Declaration of Kent M. Harvey  
13 (“Harvey Declaration”) filed herewith, the record of this case and any admissible evidence  
14 presented to the Court at or prior to the hearing on this Motion.

15                   **PLEASE TAKE FURTHER NOTICE** that pursuant to Rule 9014-1(c)(1) of the  
16 Bankruptcy Local Rules of the United States District Court for the Northern District of  
17 California, any opposition to the Motion and the relief requested herein must be filed with  
18 the Bankruptcy Court and served upon appropriate parties (including counsel for PG&E) at  
19 least 14 days prior to the scheduled hearing date. If there is no timely objection to the  
20 requested relief, the Court may enter an order granting such relief without further hearing.

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27                   <sup>1</sup> The Existing Suppliers and Additional Suppliers are sometimes collectively referred  
28 to herein as the “Suppliers.”

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1 **MEMORANDUM OF POINTS AND AUTHORITIES**

2 I.

3 **GENERAL BACKGROUND.**

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

17  
18 II.

19 **THE GAS SUPPLIER SECURITY AGREEMENT.**

20 PG&E provides gas service to approximately 3.9 million "core" residential and  
21 small business customers ("Core Customers") by purchasing approximately 1 billion cubic  
22 feet of gas each day from gas suppliers, most of whom are located outside of California.  
23 Without such purchases, PG&E cannot provide sufficient gas for heating and other essential  
24 uses for its Core Customers.

25 In the months prior to February 2001, due to PG&E's deteriorating credit  
26 situation and fears that PG&E would be unable or unwilling to pay for gas supplies on a  
27 timely basis, gas suppliers refused to sell gas to PG&E on an unsecured credit basis, even  
28 under existing gas supply contracts. Gas suppliers instead insisted on either prepayment or

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1 other form of payment assurance for gas supplies, which PG&E was unable to provide due  
2 to its dire financial condition. Harvey Decl. ¶3.

3 Based on its inability to secure and maintain a sufficient supply of gas for its  
4 Core Customers on an unsecured credit basis, on or about February 7, 2001, PG&E entered  
5 into the Gas Supplier Security Agreement with the Existing Suppliers, granting a security  
6 interest in certain of PG&E's gas-related assets in order to induce the Existing Suppliers to  
7 supply gas to PG&E. *Id.* ¶4 & Ex. A.<sup>2</sup> Pursuant to the Gas Supplier Security Agreement,  
8 PG&E granted a security interest to U.S. Trust Company, the Suppliers' Agent, for the  
9 benefit of the Suppliers, in all of its existing and after-acquired rights to payment from its  
10 Core Customers for providing natural gas or gas services (including sales and transport  
11 charges), and the proceeds thereof (collectively, the "Suppliers' Collateral"), but excluding  
12 certain rights to payment (including payment rights for the provision of electricity or  
13 electricity services, amounts collected by PG&E as a servicer under various transactions and  
14 programs, and certain taxes and fees). *Id.* ¶5.

15 For those suppliers that execute the Gas Supplier Security Agreement, the  
16 Suppliers' Collateral secures PG&E's payment obligations (collectively, the "Secured  
17 Obligations") under its Master Gas Purchase and Sale Agreements with such Suppliers for  
18 natural gas deliveries made on behalf of PG&E's Core Customers. *Id.* ¶6.<sup>3</sup> The Gas

19  
20 <sup>2</sup> The Gas Supplier Security Agreement is not attached to the service copies of the  
21 Harvey Declaration. You may obtain a copy of the Gas Supplier Security Agreement in one  
22 of the following ways: through the "Pacific Gas & Electric Company Chapter 11 Case" link  
23 accessible through the Bankruptcy Court's website ([www.canb.uscourts.gov](http://www.canb.uscourts.gov)), or by written  
24 request to Howard, Rice, Nemerovski, Canady, Falk & Rabkin, Attn: Jerome Ferrer, Three  
25 Embarcadero Center, 7th Floor, San Francisco, California 94111-4065. The identical  
26 document was also attached as Exhibit A to the Declaration of Kent Harvey in Support Of  
27 Debtor's Notice Of Motion And Debtor's Emergency Motion For Orders: (1) Authorizing  
28 Interim Use Of Cash Collateral In Which Gas Suppliers Have A Beneficial Interest;  
Scheduling And Establishing Deadlines Relating To A Final Hearing On Continued Use Of  
Cash Collateral And Incurrence Of Post-Petition Secured Debt; And (4) After Conclusion Of  
A Final Hearing, Authorizing Continued Use Of Cash Collateral, served on April 6, 2001.

<sup>3</sup> The Gas Supplier Security Agreement initially provided for a termination date of  
April 30, 2001 (unless sooner terminated based on certain specified events), but provides for  
PG&E and each of the Suppliers to extend the Agreement if the California Public Utilities  
Commission ("CPUC") extends PG&E's authority to pledge the Suppliers' Collateral to the  
(continued . . .)

1 Supplier Security Agreement requires that the aggregate value of the Suppliers' Collateral  
2 exceed the aggregate amount of the Secured Obligations at all times. *Id.* ¶7. In addition, the  
3 Gas Supplier Security Agreement requires that PG&E grant a security interest in additional  
4 property (*i.e.*, its inventory of natural gas designated for its Core Customers held in storage  
5 fields) or make payments to reduce the Secured Obligations to the Suppliers if the aggregate  
6 amount of the Secured Obligations exceeds the aggregate value of the Suppliers' Collateral.  
7 *Id.* ¶8. The Agreement further provides that the Suppliers' interest in the Suppliers'  
8 Collateral is subject to the security interest of the indenture trustee (the "Indenture Trustee")  
9 for the benefit of holders of certain mortgage bonds issued by PG&E. *Id.* ¶9.

11 III.

12 **THE COURT'S AUTHORIZATION OF THE GAS SUPPLIER**  
13 **SECURITY AGREEMENT AND PROPOSED ADDITION OF**  
14 **OTHER SUPPLIERS.**

15 By its Order On Debtor's Motion For Order Authorizing Continued Use Of Cash  
16 Collateral In Which Gas Suppliers Have A Beneficial Interest And Incurrence Of Post-  
17 Petition Secured Debt To Gas Suppliers issued on May 9, 2001, the Court, *inter alia*,  
18 authorized PG&E to incur post-petition secured debt in favor of the Existing Suppliers  
19 pursuant to the Gas Supplier Security Agreement, and to continue performing its obligations  
20 thereunder, including granting the Existing Suppliers a lien of the same extent and priority in  
21 collateral acquired post-petition by PG&E of the same type as the Suppliers' Collateral.

22 Although 16 Existing Suppliers are parties to the Gas Supplier Security  
23 Agreement, only about four or five Suppliers are actively supplying gas to PG&E pursuant  
24 to the Agreement. Harvey Decl. ¶10. In addition, PG&E has been unable to obtain a  
25 sufficient, predictable supply of gas for its Core Customers on an unsecured credit basis,

26 ( . . . continued)

27 Suppliers for the purpose of procuring gas supplies. Pursuant to its Order issued on or about  
28 February 15, 2000, the CPUC extended PG&E's authority to pledge the Suppliers' Collateral  
to the Suppliers for the purpose of procuring gas supplies until July 30, 2001. PG&E  
currently has a request pending before the CPUC that would further extend such authority  
until May 1, 2002.

1 even though suppliers providing such post-petition gas would presumably be entitled to an  
2 administrative expense claim under Bankruptcy Code Section 503(b) in the event that PG&E  
3 failed to timely pay for such gas supplies. *Id.* ¶10. PG&E seeks authority to enter into the  
4 Gas Supplier Security Agreement with Additional Suppliers to help ensure an adequate,  
5 predictable supply of gas at competitive prices for its Core Customers. *Id.* ¶10.

6           Although PG&E's purchases of gas fluctuate seasonally, during 2001, they have  
7 ranged from about \$175 million to \$375 million per month, and have amounted to an  
8 average of approximately \$290 million per month. Of this amount, approximately \$185  
9 million (i.e., about 65%) was purchased pursuant to the Gas Supplier Security Agreement.  
10 While the aggregate amount of the Secured Obligations and the aggregate value of the  
11 Suppliers' Collateral vary on a daily basis based on ongoing gas deliveries and payments, for  
12 purposes of illustrating their relative amounts, PG&E's accounts receivables securing its  
13 obligations under the Gas Supplier Security Agreement have ranged from approximately  
14 \$470 million to \$965 million per month during February through May 2001, and have  
15 averaged approximately \$740 million per month during this time. *Id.* ¶10.

16           Significantly, if the Motion is granted, PG&E's obligations to the Additional  
17 Suppliers under the Gas Supplier Security Agreement would be secured by the same  
18 collateral as that securing its obligations to the Existing Suppliers (*i.e.*, the Suppliers'  
19 Collateral). Thus, the relief requested by the Motion would not encumber assets of the estate  
20 that are currently unencumbered, but would instead increase the number of Suppliers  
21 benefiting from such security interest.

22           Furthermore, the Indenture Trustee, who holds a lien on substantially all of  
23 PG&E's assets for the benefit of the mortgage bondholders, has consented to including  
24 Additional Suppliers in the Gas Supplier Security Agreement. Such consent is apparently  
25 required under the Cash Collateral Stipulation between PG&E and the Indenture Trustee  
26 (which was approved by a separate Order issued by the Court on May 9, 2001).

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IV.

PG&E SHOULD BE AUTHORIZED TO INCUR POST-PETITION  
SECURED DEBT TO THE ADDITIONAL SUPPLIERS UNDER  
THE GAS SUPPLIER SECURITY AGREEMENT PURSUANT TO  
BANKRUPTCY CODE SECTION 364.

Bankruptcy Code Section 364(c)(3) provides, in pertinent part, as follows:

“If the trustee is unable to obtain unsecured credit allowable under Section 503(b)(1) of this title as an administrative expense, the court, after notice and a hearing, may authorize the obtaining of credit or the incurring of debt . . . secured by a junior lien on property of the estate that is subject to a lien.” (11 U.S.C. §364(c)(3))

Thus, the only statutory prerequisite for obtaining credit on a secured basis is that the debtor be unable to obtain unsecured credit allowable as an administrative expense. This test is clearly satisfied in this case. As discussed above, PG&E has been unable to obtain a sufficient, reliable supply of essential gas for its Core Customers on an unsecured credit basis, even though claims arising from such supplies would presumably be entitled to administrative priority under Section 503(b) if PG&E failed to timely pay for such gas.

In determining whether to approve a transaction under Section 364, courts act in their informed discretion. *In re Ames Dep't Stores, Inc.*, 115 B.R. 34, 37 (Bankr. S.D.N.Y. 1990). Courts have established that such discretion is to be utilized to permit the debtor's reasonable business judgment to be exercised so long as the financing agreement does not contain terms that are primarily designed to benefit the secured party at the expense of the estate or leverage the bankruptcy process. *Id.* at 39-40; *In re Simasko Prod. Co.*, 47 B.R. 444, 449 (D. Colo. 1985). In undertaking such analysis, courts focus on the following principal factors: proposed terms that would tilt the conduct of the bankruptcy case; prejudice, at the early stages, to the powers and rights that the Bankruptcy Code confers for the benefit of all creditors; or terms that leverage the Chapter 11 process by preventing motions by parties in interest from being decided on their merits. *In re Tenney Village Co.*, 104 B.R. 562, 567-70 (Bankr. D.N.H. 1989); *Norris Square Civic Ass'n v. St. Mary Hosp.* (*In re St. Mary Hosp.*), 86 B.R. 393, 401-02 (Bankr. E.D. Pa. 1988); *In re Crouse Group, Inc.*, 71 B.R. 544, 550-51 (Bankr. E.D. Pa. 1987).

1 In this case, as discussed above, PG&E seeks to include Additional Suppliers  
2 under the Gas Supplier Security Agreement in order to assure an adequate, reliable supply of  
3 essential gas to its millions of Core Customers. Thus, such financing is clearly in the best  
4 interests of the estate and all parties in interest in this case, and is well within PG&E's sound  
5 business judgment. As the Court necessarily determined in connection with its prior  
6 approval of the Gas Supplier Security Agreement, the Agreement does not contain terms that  
7 are primarily designed to benefit the secured parties thereunder at the expense of the estate  
8 or leverage the bankruptcy process. Accordingly, the Court should authorize PG&E to incur  
9 post-petition secured debt to the Additional Suppliers under Section 364.

10 V.

11 CONCLUSION.

12 For all of the foregoing reasons, PG&E respectfully requests that this Court make  
13 and enter its order:

14 1. Granting the Motion.

15 2. Authorizing PG&E to incur post-petition secured debt in favor of the  
16 Additional Suppliers that sell gas on credit to PG&E pursuant to the Gas Supplier Security  
17 Agreement, and to continue performing all of its obligations pursuant to the Gas Supplier  
18 Security Agreement until the scheduled termination of the Gas Supplier Security Agreement,  
19 and any extensions thereof the Gas Supplier Security Agreement to which PG&E and any  
20 Additional Supplier may agree, without further order of this Court.

21 3. Granting such other relief as the Court deems just and appropriate.

22 DATED: June 26, 2001

Respectfully,

23 HOWARD, RICE, NEMEROVSKI, CANADY,  
24 FALK & RABKIN  
A Professional Corporation

25 By:   
26 GARY M. KAPLAN

27 Attorneys for Debtor and Debtor in Possession  
28 PACIFIC GAS & ELECTRIC COMPANY

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