

1 JAMES L. LOPES (No. 63678)  
JEFFREY L. SCHAFFER (No. 91404)  
2 JANET A. NEXON (No. 104747)  
HOWARD, RICE, NEMEROVSKI, CANADY,  
3 FALK & RABKIN  
A Professional Corporation  
4 Three Embarcadero Center, 7th Floor  
San Francisco, California 94111-4065  
5 Telephone: 415/434-1600  
Facsimile: 415/217-5910

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6 Attorneys for Debtor and Debtor in Possession  
7 PACIFIC GAS AND ELECTRIC COMPANY

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

12 In re  
13 PACIFIC GAS AND ELECTRIC  
COMPANY, a California corporation,  
14 Debtor.  
15 Federal I.D. No. 94-0742640

No. 01-30923 DM  
Chapter 11 Case  
Date: July 31, 2001  
Time: 9:30 a.m.  
Place: 235 Pine St., 22nd Floor  
San Francisco, California  
Judge: Hon. Dennis Montali

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18 DEBTOR'S NOTICE OF MOTION AND MOTION FOR ORDER AUTHORIZING  
19 ASSUMPTION OF FRANCHISE AGREEMENTS;  
20 MEMORANDUM OF POINTS AND AUTHORITIES IN SUPPORT THEREOF

21 [SUPPORTING DECLARATION OF  
22 RUSSELL JORGENSEN FILED SEPARATELY]

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1 INTRODUCTION

2 Pursuant to Section 365(a) of the Bankruptcy Code (11 U.S.C. §365(a)), Pacific Gas &  
3 Electric Company, the debtor and debtor in possession of the above-captioned Chapter 11  
4 case ("PG&E" or the "Debtor"), hereby moves this Court for an authorizing assumption of  
5 approximately 510 franchise agreements between PG&E and various cities and counties in  
6 California (collectively the "Franchise Agreements"). The Franchise Agreements allow  
7 PG&E to install, operate and maintain its electric, gas, oil and water facilities in the public  
8 streets and roads owned by local governments. Declaration of Russell Jorgensen filed  
9 concurrently herewith ("Jorgensen Decl.") ¶2. In exchange for the right to use public streets  
10 and roads, city and county franchises require utilities to pay an annual fee as a condition for  
11 the continued enjoyment of the franchise. *Id.* Because PG&E has ongoing obligations to  
12 pay these annual franchise fees, these Franchise Agreements are executory. PG&E therefore  
13 may assume these contracts with the approval of this Court. *See* 11 U.S.C. §365(a).

14 The Franchise Agreements include 238 gas franchises, 267 electric franchises, 4 oil  
15 pipe line franchises, and 1 water franchise. Detailed listings of the Franchise Agreements  
16 are attached as Exhibit A to the Jorgensen Declaration.

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18 I.

19 THE FRANCHISE AGREEMENTS.

20 California cities and counties have granted PG&E permission to install, operate and  
21 maintain electric, gas, oil and water facilities in the public streets and roads owned by the  
22 local governments. The cities and counties have authority to grant these franchises pursuant  
23 to the Broughton Act (Cal. Pub. Util. Code §§6001 *et seq.*), the Franchise Act of 1937 (Cal.  
24 Pub. Util. Code §§2601 *et seq.*), and city charters. Typically, the franchises are granted by  
25 the issuance of a municipal ordinance.

26 In exchange for the right to use public streets and roads, the franchises require utilities  
27 to pay an annual fee. Franchise fees are not considered a tax or a license fee for the right to  
28 do business; instead, the fees are required as a condition for the granting of the franchise.

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1 The franchises do not grant the right to conduct a particular business; they merely confer  
2 upon the utility the right to use public rights-of-way, subject to certain requirements. County  
3 of Sacramento v. Pacific Gas & Elec. Co., 193 Cal. App. 3d 300, 313 (1987). In return, a  
4 utility, such as PG&E, is required to pay franchise fees and to relocate equipment when  
5 necessary to accommodate such public projects as street widening and grade changes. The  
6 California Supreme Court has determined that the franchise fee is a "toll," not a tax. County  
7 of Tulare v. City of Dinuba, 188 Cal. 664, 670 (1922).

8 Except with respect to charter cities, public utility franchises are granted either under  
9 the Broughton Act or the Franchise Act of 1937. The principal difference between the two  
10 Acts is the method used to calculate the annual franchise fee. Counties and general-law  
11 cities may not vary the terms and conditions of their franchises from the provisions of the  
12 Acts. Charter cities, however, are free to set fees of their own determination. (About four-  
13 fifths of California cities are general-law cities; the remainder are charter cities.) Jorgensen  
14 Dec. ¶4.

15 Under the Broughton Act, the fee is computed using a formula established by court  
16 decisions interpreting the Act. This formula takes into consideration a number of factors,  
17 such as the utility's gross receipts, investment in plant, and miles of lines along county roads  
18 or city streets. The formula computes a factor for gross receipts per mile, which is  
19 multiplied by the miles of line within the franchise area of a county or city to determine the  
20 total receipts attributable to the use of that franchise. The franchise payment is equal to two  
21 percent (2%) of these receipts. All of PG&E's county electric and gas franchises and some  
22 of its city franchises were granted under the provisions of the Broughton Act. Jorgensen  
23 Decl. ¶5.

24 Under the Franchise Act of 1937, the fee is established as the higher of either the fee  
25 that would result under a Broughton Act calculation or a fixed percentage of gross receipts  
26 from the sale of electricity or gas within the city. When the fee is based on gross receipts  
27 from sales within a city, the utility pays either one-half of one percent (0.5%) or one percent  
28 (1%), depending on whether the utility also holds a constitutional franchise to use the city

1 streets for lighting purposes. With a few exceptions, all of PG&E's gas and electric  
2 franchises with general-law cities were granted according to the provisions of the Franchise  
3 Act of 1937. Jorgensen Decl. ¶6.

4 Charter cities can require a fee rate different from the rate set by either of the two Acts.  
5 For instance, San Jose, a charter city, has a franchise fee rate of two percent (2%) of the  
6 gross receipts from sales within the city for both the electric and gas franchises. Jorgensen  
7 Decl. ¶7.

8 The Franchise Agreements are essential to PG&E's business, allowing PG&E to  
9 transmit and distribute electricity, gas, oil and water to its customers. If PG&E is unable to  
10 assume the Franchise Agreements, cities and counties could force PG&E to remove its  
11 facilities from the public streets, and PG&E could be forced to exercise its power of eminent  
12 domain to secure easements in the public streets for its existing facilities or, alternatively,  
13 PG&E would have to renegotiate the Franchise Agreements with the various cities and  
14 counties and as a result could be required to incur significantly higher costs than are  
15 currently incurred. Jorgensen Decl. ¶3. Thus, PG&E's assumption of the Franchise  
16 Agreements is critical to continuing its gas and electric business.

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18 II.

19 ARGUMENT.

20 Bankruptcy Code Section 365 governs the treatment of executory contracts following  
21 the filing of a bankruptcy petition: a "trustee, subject to the court's approval, may assume or  
22 reject any executory contract or unexpired lease of the debtor." 11 U.S.C. §365(a).<sup>1</sup> By this  
23 Motion, PG&E asks the Court to enter an order pursuant to Section 365(a) authorizing it to  
24 assume the Franchise Agreements.

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27 <sup>1</sup>PG&E may assume executory contracts with the Court's approval because the  
28 Bankruptcy Code gives a debtor in possession the rights, powers, functions, and duties of a  
trustee. See 11 U.S.C. §1107(a).

1           A.   The Franchise Agreements Are Executory Contracts.

2           The Bankruptcy Code, although addressing the treatment of executory contracts upon  
3 the filing of a bankruptcy petition, does not define the term “executory contract.” The  
4 federal courts have, however, construed the term in a common fashion. Based on the  
5 legislative history, the Supreme Court has defined “executory contract” as a contract on  
6 which “performance is due to some extent on both sides.” NLRB v. Bildisco & Bildisco,  
7 465 U.S. 513, 522 n.6 (1984) (citation omitted). Similarly, the Ninth Circuit has held that  
8 Section 365 refers to those contracts “in which the obligations of both parties ‘are so far  
9 unperformed that the failure of either to complete performance would constitute a material  
10 breach excusing the performance of the other.’” Elliott v. Four Seasons Props. (In re  
11 Frontier Props., Inc.), 979 F.2d 1358, 1364 (9th Cir. 1992) (quoting Pacific Express, Inc. v.  
12 Teknikron Infoswitch Corp. (In re Pacific Express, Inc.), 780 F.2d 1482, 1487 (9th Cir.  
13 1986) (citation omitted)). While the determination of whether a contract is executory for  
14 bankruptcy purposes is a matter of federal law, the issue of whether a party’s failure to  
15 perform its remaining contract obligations constitutes a material breach is one of state law.  
16 See 976 F.2d at 1272; Griffel v. Murphy (In re Wegner), 839 F.2d 533, 536 (9th Cir. 1988).

17           Although the Franchise Agreements for the most part are established by city or county  
18 ordinances, they are essentially contracts and have been recognized as such by California  
19 courts. See County of Sacramento v. Pacific Gas & Elec. Co., 193 Cal. App. 3d at 305 &  
20 308 n.5 “acceptance of a franchise is a matter of contract . . . Broughton Act franchise is  
21 contractual in the sense that the utility and the municipality enter[ed] into the relationship by  
22 mutual agreement”); Santa Barbara County Taxpayers Ass’n v. Board of Supervisors, 209  
23 Cal. 3d 940, 949 (1989) (“A franchise is a negotiated contract between a private enterprise  
24 and a governmental entity for the long-term possession of land”).

25           As contracts under California law, any failure on PG&E’s part to continue making  
26 payments consistent with the terms of the Franchise Agreements will qualify as a material  
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1 breach:<sup>2</sup> “[T]he several obligations of the parties constitute to each, reciprocally, the  
2 consideration of the contract; and a failure to perform constitutes a failure of consideration  
3 either partial or total . . . .” Bliss v. California Coop. Producers, 30 Cal. 2d 240, 249 (1947)  
4 (citation omitted). In considering this same contract principle under Arizona law, the Ninth  
5 Circuit held that the duty to pay money on one side is a material obligation sufficient to  
6 render the contract executory where corresponding material obligations exist on the other  
7 side. In re Wegner, 839 F.2d at 537. In Fenix Cattle Co. v. Silver (In re Select-A-Seat  
8 Corp.), 625 F.2d 290, 292 (9th Cir. 1980), for example, the Ninth Circuit held a licensing  
9 agreement executory where the debtor, Select-A-Seat, had entered into a worldwide  
10 exclusive licensing agreement with Fenix Cattle Company. Under this agreement, Fenix  
11 received exclusive rights to use and license Select-A-Seat’s software packages in all but five  
12 areas of the world and, in turn, contracted to pay Select-A-Seat \$140,000 down plus five  
13 percent of its annual net income from use of the licenses. In considering Fenix’s argument  
14 that the contract was no longer executory because it had received license rights to the  
15 software upon payment of the initial \$140,000 fee, the court considered germane that Fenix  
16 was also obligated to pay Select-A-Seat five percent of its annual net return from use of the  
17 software: “If Fenix failed to make these annual payments, that failure would constitute a  
18 material breach of the contract . . . . Conversely, the agreement was executory from Select-  
19 A-Seat’s perspective. Because of the exclusive nature of the license . . . Select-A-Seat was  
20 under a continuing obligation not to sell its software packages to other parties.” Id.

21 Under this framework provided by the Ninth Circuit, each of the Franchise Agreements  
22 PG&E seeks to assume by this Motion is executory.

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25 <sup>2</sup>In addition, failure to pay the franchise fees could also result in forfeiture of the  
26 franchise pursuant to the terms of the ordinance. For example, in Ordinance No. 459 of the  
27 City of Sausalito granting PG&E an electricity franchise, “[a]ny neglect, omission or refusal  
28 by said grantee [PG&E] to file such verified statement, or to pay said percentage at the time  
and in the manner specified, shall be grounds for the declaration of a forfeiture of this  
franchise and of all rights of grantee hereunder.”

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1 B. PG&E's Assumption Of The Executory Contracts Is Based On Sound Business  
2 Judgment.

3 The Bankruptcy Code does not provide courts with a standard to use in determining the  
4 propriety of a debtor in possession's decision to assume or reject an executory contract.  
5 3 Lawrence P. King, Collier on Bankruptcy ¶365.03[1], at 365-22 (15th ed. rev. 2000). The  
6 widely accepted test among federal courts, however, is the business judgment standard. See  
7 Bildisco, 465 U.S. at 523; Group of Institutional Investors v. Chicago, 318 U.S. 523, 550  
8 (1943) (“[T]he question whether a lease should be rejected and if not on what terms it should  
9 be assumed is one of business judgment”). Under this rule, courts accord great deference to  
10 a debtor in possession's decision to assume an executory contract. See, e.g., Orion Pictures  
11 Corp. v. Showtime Networks, Inc. (In re Orion Pictures Corp.), 4 F.3d 1095, 1098 (2d Cir.  
12 1993) (“At heart, a motion to assume should be considered a summary proceeding”);  
13 Lubrizol Enters., Inc. v. Richmond Metal Finishers, Inc. (In re Richmond Metal Finishers,  
14 Inc.), 756 F.2d 1043, 1046 (4th Cir. 1985) (“Lubrizol”) (“[T]he bankrupt's decision . . . is to  
15 be accorded the deference mandated by the sound business judgment rule as generally  
16 applied by courts to discretionary actions or decisions of corporate directors”); In re III  
17 Enters., Inc., 163 B.R. 453, 469 (Bankr. E.D. Pa.), aff'd, 169 B.R. 551 (E.D. Pa. 1994) (“We  
18 will not substitute our own business judgment for that of the Debtor . . . unless ‘the decision  
19 is so unreasonable that it could not be based on sound business judgment, but only on bad  
20 faith or whim’”) (citations omitted); Summit Land Co. v. Allen (In re Summit Land Co.), 13  
21 B.R. 310, 315 (Bankr. D. Utah 1981) (“[C]ourt approval under Section 365(a), if required,  
22 except in extraordinary situations, should be granted as a matter of course. To begin, this  
23 rule places responsibility for administering the estate with the trustee, not the court”).

24 Ninth Circuit courts, in accordance with the widely accepted standard, have adopted  
25 the business judgment rule for reviewing Section 365(a) motions: “We believe the ‘business  
26 judgment’ rule is the standard which controls the court's right to disapprove the [debtor in  
27 possession's] decision to reject an executory contract . . . Virtually all recent Bankruptcy  
28 Court decisions follow this rule.” Robertson v. Pierce (In re Chi-Feng Huang), 23 B.R. 798,

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1 800 (B.A.P. 9th Cir. 1982) (citations omitted); see Upland/Euclid, Ltd. v. Grace Rest. Co.  
2 (In re Upland/Euclid, Ltd.), 56 B.R. 250, 251 n.1 (B.A.P. 9th Cir. 1985) (“Whether a lease  
3 should be rejected is a matter for the debtor’s business judgment.”); Turbowind, Inc. v. Post  
4 Street Mgmt., Inc. (In re Turbowind, Inc.), 42 B.R. 579, 585 (Bankr. S.D. Cal. 1984) (“The  
5 debtor has met its burden under the liberal ‘business judgment’ standard”). Under the rule as  
6 generally formulated and applied in corporate litigation, courts defer to decisions of  
7 corporate directors regarding matters entrusted to their business judgment except upon a  
8 finding of bad faith or gross abuse of business discretion. See Lubrizol, 756 F.2d at 1047;  
9 Lewis v. Anderson, 615 F.2d 778, 782 (9th Cir. 1979). Transposed to the bankruptcy  
10 context, the business judgment rule as applied to PG&E’s decision to assume the Franchise  
11 Agreements because of perceived business advantage requires that the Court approve this  
12 Motion unless PG&E has made such decision in bad faith or is grossly abusing its business  
13 discretion. See Lubrizol, 756 F.2d at 1046-47; In re GP Express Airlines, Inc., 200 B.R.  
14 222, 230 (Bankr. D. Neb. 1996) (“Absent a showing of bad faith or abuse of debtor’s  
15 discretion, however, debtor’s exercise of business judgment in deciding whether to assume a  
16 lease will generally not be disturbed”).

17 PG&E’s assumption of the Franchise Agreements is based on a sound business  
18 decision and is necessary for a successful reorganization. Most significantly, PG&E’s  
19 ability to operate its gas and electricity distribution business depends on the Franchise  
20 Agreements.

21 If the Court does not authorize PG&E to assume the Franchise Agreements, the cities  
22 and counties could seek to terminate the Franchise Agreements, could force PG&E to  
23 remove its facilities from the public streets, could result in PG&E having to file hundreds of  
24 eminent domain actions to preserve its facilities’ locations (see Shell California Pipeline Co.  
25 v. City of Compton, 35 Cal. App. 4th 1116 (1995)), or could force PG&E to renegotiate for  
26 higher franchise fees or other franchisee-paid obligations. Such a result could significantly  
27 increase PG&E’s operating costs, diminishing the assets available to satisfy the claim of  
28 creditors.

1 In light of these factors, the exercise of PG&E's business judgment compels the  
2 assumption of the Franchise Agreements.

3  
4 C. There Are No Defaults Under The Franchise Agreements.

5 Because there are no defaults under the Franchise Agreements, PG&E is not required  
6 to provide adequate assurance of future performance under 11 U.S.C. Section 365(b)(1).  
7 PG&E has made its annual franchise fee payments on a timely basis, according to the terms  
8 of each Franchise Agreement. Jorgensen Decl. ¶8.

9 Nevertheless, PG&E clearly has the financial capability, based on its operating  
10 revenues and cash reserves (as previously disclosed to the Court) to perform its obligations  
11 under the Franchise Agreements. Further, the franchise fees are a component of the rates  
12 that the California Public Utilities Commission has authorized PG&E to charge its  
13 customers. Jorgensen Decl. ¶8. PG&E's franchise fee payments to the cities and counties  
14 for the year 2000 were approximately \$76 million in the aggregate, not including surcharges.  
15 See Jorgensen Decl. Ex. B. Based on current data, PG&E reasonably expects its 2001  
16 franchise fee payments to be at least as much as its franchise fees for the year 2000.

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III.

CONCLUSION

For the foregoing reasons and pursuant to 11 U.S.C. Section 365, PG&E respectfully requests that the Court enter an order authorizing PG&E to assume the Franchise Agreements.

DATED: July 3, 2001

Respectfully,

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

By: Janet Nexon  
JANET A. NEXON

Attorneys for Debtor and Debtor in Possession  
PACIFIC GAS AND ELECTRIC COMPANY

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& RABKIN  
A Professional Corporation