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50-275/323

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.

No. 01-30923 DM  
Chapter 11 Case

MEMORANDUM OF POINTS AND  
AUTHORITIES IN SUPPORT OF  
MOTION FOR AUTHORITY TO  
ASSUME POWER PURCHASE  
AGREEMENTS BETWEEN PG&E AND  
CERTAIN QUALIFYING FACILITIES

Date: August 3, 2001  
Time: 1:30 p.m.  
Place: 235 Pine Street, 22nd Floor  
San Francisco, California  
Judge: Hon. Dennis Montali

20 Federal I.D. No. 94-0742640  
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HOWARD  
RICE  
NEMEROVSKI  
CANADY  
FALK  
& RABKIN  
A Professional Corporation

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## I. INTRODUCTION

Pacific Gas and Electric Company (“PG&E”), debtor and debtor-in-possession herein, commenced this Chapter 11 case by filing a voluntary petition on April 6, 2001. PG&E continues to manage and operate its property as a debtor-in-possession pursuant to Sections 1107 and 1108 of the Bankruptcy Code. PG&E submits this Memorandum of Points and Authorities in Support of Debtor’s Motion For Authority To Assume Power Purchase Agreements Between PG&E And Certain Qualifying Facilities (the “Motion”).

As the Court is aware, PG&E currently has long-term energy contracts (“Power Purchase Agreements” or “PPAs”) with 332 Qualifying Facilities (“QFs”). See the declaration of Janos Laszlo (“Laszlo Decl.”) filed concurrently herewith. Laszlo Decl. ¶3, ¶4. On June 13, 2001, the California Public Utilities Commission (“CPUC”) issued Decision 01-06-105 (the “Lynch Decision”), which allows QFs to notify PG&E on or before July 15, 2001, of their intent to modify their long-term contracts by (a) electing to received a fixed price of 5.37 cents per kWh, rather than the floating SRAC price for a five-year period; (b) demonstrating hardship and thereby becoming eligible to receive a modified SRAC payment for a one-year period; or (c) selling “excess power” to PG&E for 125% of the modified SRAC price. See *id.* ¶6.

After CPUC issued the Lynch Decision, PG&E sought and obtained this Court’s approval to amend and assume a number of its PPAs with QFs pursuant to Section 363(b) and 365(b)(1) or the Bankruptcy Code, and Rules 4001, 6004 and 9019 of the Federal Rules of Bankruptcy Procedure. See *id.* ¶7. As part of those efforts, PG&E generally requested authorization to enter into amendments to the PPAs to take advantage of the five-year pricing option provided by the “price modification” amendment in the Lynch Decision. See *id.* PG&E also sought and obtained amendments providing that: (a) the assumption was effective upon entry of a Court order approving the Agreement (provided that, in some instances, QFs are permitted to “exit” the Agreement for a short period of time, in the event

1 that they are unable to obtain necessary approvals or financing), (b) the agreement regarding  
2 the amount necessary to “cure” pre-petition defaults (subject to a reservation of rights in  
3 some instances) (the “Pre-Petition Payables”), (c) the waiver of certain claims by the QFs  
4 (i.e., claims for payments in excess of the “contract rate” during the “pre-assumption”  
5 period), (d) the deferral of payment of the Pre-Petition Payables until either (i) the Effective  
6 Date of the Plan of Reorganization confirmed in this case (the “Calpine Model”) or (ii) July  
7 15, 2003, after which date, PG&E agrees to pay two percent of the principal amount of the  
8 Pre-Petition Payables, until paid in full, or Effective Date (the “GWF Model”), and (e) the  
9 reservation of certain issues (interest rate on Pre-Petition Payables) until confirmation of the  
10 Plan. See Laszlo Decl ¶7.

11 To date, PG&E has assumed approximately 130 of its 332 PPAs with its QFs;  
12 those contracts represent two-thirds of the aggregate “nameplate capacity” of QFs. See id.  
13 ¶9. The remaining contracts with QFs involve smaller companies, which are less likely to  
14 hire counsel and initiate negotiation on their own initiative. See id. ¶12. PG&E has thus  
15 taken proactive steps and mailed form amendments to the QFs, informing the QFs of  
16 PG&E’s interest in amending and assuming the PPAs. See id. ¶12; see also Exh. A.

17 Although the initial Lynch Decision was to expire on July 14, 2001, on July 12,  
18 2001, CPUC extended the deadline for the “hardship” and “excess capacity” amendment  
19 provisions. See id. ¶11. A week later, on July 19, 2001, Administrative Law Judge John S.  
20 Wong issued a ruling that purported to extend the deadline for the “price modification”  
21 amendment provision as well. See id. If CPUC expressly rules that the “price modification”  
22 amendment deadline has been extended, then PG&E is prepared to enter into amendments  
23 and assume the PPAs of any QFs that want to take advantage of such procedures on terms no  
24 less favorable to PG&E than those set forth in the GWF Model. See id.

25 PG&E therefore brings this motion for blanket authority to assume, with  
26 amendment, the PPAs of the remaining QFs on terms not less favorable to PG&E than those  
27 that this Court has already approved, subject to at least 48 hours advance notice to the  
28 Official Committee of Unsecured Creditors and its counsel. PG&E also seeks authority to

1 pay immediately the Pre-Petition Payables for the remaining QFs if the total payable is less  
2 than \$10,000 (with the QFs agree to waive any claims for pre-petition and/or post-petition  
3 interest).

## 4 5 II. DISCUSSION

### 6 A. This Court Should Authorize PG&E To Assume, With Amendment, Any 7 PPAs With The Remaining QFs On Terms No Less Favorable Than Those 8 That This Court Has Already Approved.

9 Under 11 U.S.C. Section 365, “a trustee [or debtor-in-possession],[<sup>1</sup>] subject to  
10 the court’s approval, may assume or reject any executory contract or unexpired lease of the  
11 debtor.” 11 U.S.C. §365(a). A contract is generally executory, and therefore subject to  
12 Section 365, if “performance is due to some extent on both sides.” NLRB v. Bildisco &  
13 Bildisco, 465 U.S. 513, 522 n.6 (1984) (citation omitted); see also Commercial Union Ins.  
14 Co. v. Texscan Corp. (In re Texscan Corp.), 976 F.2d 1269, 1272 (9th Cir. 1992) (holding  
15 that Section 365 refers to those contracts in which the obligations of both parties “are so far  
16 unperformed that the failure of either to complete performance would constitute a material  
17 breach and thus excuse the performance of the other”); Elliott v. Four Seasons Props. (In re  
18 Frontier Props., Inc.), 979 F.2d 1358, 1364 (9th Cir. 1992) (similar).

19 It is unquestionable that the PPAs are executory contracts. Under the agreements,  
20 PG&E has an obligation to pay for energy, and the QFs have a duty to provide energy, until  
21 about 2015. See Laszlo Decl. ¶5. Pursuant to 11 U.S.C. Section 365, PG&E therefore seeks  
22 blanket Court approval to assume the remaining PPAs, with amendments on terms no less  
23 favorable to PG&E than those that this Court has already approved, subject to at least 48  
24 hour advance notice to the Official Committee of Unsecured Creditors and its counsel.

25 When deciding whether assumption or rejection is appropriate, courts use the  
26 “business-judgment test.” See Durkin v. Bendor Corp. (In re G.I. Indus., Inc), 204 F.3d

27 <sup>1</sup>“While section 365 speaks in terms of the trustee's powers, a debtor in possession has  
28 the rights and powers of the trustee.” In re Mushroom Transp. Co., 78 B.R. 754, 758 n.4  
(Bankr. E.D. Pa. 1987).

1 1276, 1282 (9th Cir. 2000) (“[A] bankruptcy judge applies the business judgment rule to  
2 evaluate a trustee’s rejection decision”); In re Southern California Sound Sys., Inc., 69 B.R.  
3 893, 896 (Bankr. S.D. Cal. 1987) (“Most courts have allowed the trustees to exercise their  
4 business judgment in determining which contracts to assume or reject”); see also Robertson  
5 v. Pierce (In re Chi-Feng Huang), 23 B.R. 798, 800 (B.A.P. 9th Cir. 1982) (similar);  
6 Upland/Euclid, Ltd. v. Grace Rest. Co. (In re Upland/Euclid, Ltd.), 56 B.R. 250, 251 n.1  
7 (B.A.P. 9th Cir. 1985) (similar).

8 Under this test, courts accord great deference to a debtor-in-possession’s decision  
9 to assume an executory contract. See, e.g., Orion Pictures Corp. v. Showtime Network, Inc.  
10 (In re Orion Pictures Corp.), 4 F.3d 1095, 1098 (2d Cir. 1993) (“At heart, a motion to  
11 assume should be considered a summary proceeding”); In re III Enter., Inc., 163 B.R. 453,  
12 469 (Bankr. E.D. Pa. 1994) (“We will not substitute our own business judgment for that of  
13 the Debtor . . . unless the decision is so unreasonable that it could not be based on sound  
14 business judgment, but only on bad faith or whim”) (citations omitted); Summit Land Co. v.  
15 Allen (In re Summit Land Co.), 13 B.R. 310, 315 (Bankr. D. Utah 1981) (“[C]ourt approval  
16 under Section 365(a), if required, except in extraordinary situations, should be granted as a  
17 matter of course. To begin, this rule places responsibility for administering the estate with  
18 the trustee, not the court”).

19 In essence, courts require the debtor-in-possession “merely to produce any  
20 credible evidence that rejection would benefit the estate or result in a successful  
21 reorganization.” In re Prime Motor Inns, 124 B.R. 378, 382 (Bankr. S.D. Fla. 1991) (citation  
22 and internal quotation marks omitted); cf. Phar-Mor, Inc. v. Strouss Bldg. Assoc., 204 B.R.  
23 948, 951 n.1 (N.D. Ohio 1997) (noting that “Section 365 is designed to give the trustee the  
24 option of assuming contracts where performance by a third party will benefit the estate or to  
25 forego the third party's performance where the benefit to the estate will be less than the  
26 cost”); Orion Pictures Corp., 4 F.3d at 1098 (“Section 365 permits the trustee or debtor-in-  
27 possession, subject to the approval of the bankruptcy court, to go through the inventory of  
28 executory contracts of the debtor and decide which ones it would be beneficial to adhere to

1 and which ones it would be beneficial to reject”).

2 Any decision by PG&E to assume the PPAs, with amendments no less favorable  
3 than those already approved by this Court, will unquestionably comport with the business  
4 judgment rule, as the Court has already determined on three separate occasions.

5 Specifically, the assumptions of the PPAs, with amendments, contain three key  
6 beneficial features for the bankruptcy estate and the reorganization process. First, the “price  
7 modification” amendment, as authorized by the Lynch Decision, will help eliminate  
8 potential volatility in power costs over the next five years. See Laszlo Decl. ¶10. Reducing  
9 such volatility will significantly aid PG&E in its efforts to successfully reorganize. Second,  
10 for those QFs with pre-petition payables of more than \$10,000, the amendment defers any  
11 payment of those payables for at least two years and, in some circumstances, until the  
12 Effective Date of PG&E’s confirmed plan of reorganization. See id. The delay in these  
13 payments will aid PG&E in its efforts to successfully reorganize. Finally, although none of  
14 the remaining QFs have claimed that they are due market rates for pre-assumption, post-  
15 petition power purchases, the amendment prevents those QFs from ever making such claims.  
16 See id. Such a waiver benefits PG&E in its efforts to successfully reorganize by adding  
17 certainty to the cost of PG&E’s post-petition, pre-assumption power purchases.

18 Taken together, the three key features of the amendments to the PPAs  
19 demonstrate that the assumption of these modified agreements would comport with  
20 legitimate business judgment.

21 Moreover, PG&E’s request for blanket authority to assume these modified PPAs  
22 also comports with the business-judgment test. As noted above, this Court has already  
23 previously approved the assumption of PPAs with these amendments and PG&E merely  
24 seeks authority to assume the remaining PPAs with amendments no less favorable to PG&E.  
25 The remaining QFs are numerous (over 200) and the PPAs involve relatively small amounts  
26 of money. See Laszlo Decl. ¶12. Giving PG&E blanket authority to assume these amended  
27 PPAs would save the estate the significant time and expense of having to move the Court on  
28 a seriatim basis. See id. ¶14. Moreover, no creditor has objected thus far to the assumption

1 of the PPAs and, given the significant benefits to the estate of the amended PPAs, there is no  
2 reason to believe any creditor would object to the assumption of the amended PPAs. See,  
3 e.g., id. In those circumstances, the estate would receive a significant benefit by not having  
4 to provide notice to all creditors and interested parties on a seriatim basis.<sup>2</sup> See id.

5 For all of these reasons, PG&E's request for blanket authority to assume the  
6 PPAs, with amendments no less favorable than those that this Court has already approved,  
7 comports with the business-judgment rule and therefore satisfies the requirements of 11  
8 U.S.C. Section 365. This Court should therefore grant PG&E's blanket request.

9  
10 **B. Authorizing PG&E To Pay Immediately Pre-Petition Payables Of Less Than**  
11 **\$10,000 Will Benefit The Estate.**

12 Under 11 U.S.C. Section 363(b)(1), "the trustee [or debtor-in-possession], after  
13 notice and hearing, may use, sell, or lease, other than in the ordinary course of business,  
14 property of the estate." As above, the test under Section 363(b)(1) is generally whether the  
15 debtor-in-possession has exercised a legitimate business judgment in seeking to use estate  
16 property. See In re Continental Air Lines, Inc., 780 F.2d 1223, 1226 (5th Cir. 1986) ("That  
17 is, for the debtor-in-possession or trustee to satisfy its fiduciary duty to the debtor, creditors  
18 and equity holders, there must be some articulated business justification for using, selling, or  
19 leasing the property outside the ordinary course of business"); In re St. Petersburg Hotel  
20 Assoc., Ltd., 37 B.R. 341, 343 (Bankr. M.D. Fla. 1983) ("Bankruptcy Code § 363 also  
21 impliedly requires the Court to find that it is good business judgment for the Debtor to enter  
22 into the leases"); see also In re Lehigh Valley Prof'l. Sports Clubs, Inc., 2000 WL 567905  
23 (Bankr. E.D. Pa. May 05, 2000) (No. 00-11296DWS) (so holding); Lawrence P. King,  
24 COLLIERS ON BANKRUPTCY, §363.02(1)(g), at 363-14 (15th rev. ed. 2001) (noting the same).

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26  
27 <sup>2</sup>As noted above, PG&E would give the Official Committee of Unsecured Creditors  
28 and its counsel at least 48 hour advance notice before any assumption.

1 Once again, then, the question is whether the use of estate property will benefit the estate or  
2 a successful reorganization.

3 PG&E seeks blanket authority pursuant to Section 363(b)(1) to use cash of the  
4 estate to pay pre-petition payables of the remaining QFs when the total pre-petition payables  
5 is less than and equal to \$10,000, subject to the QFs waiver of any pre- or post-petition  
6 interest. Such authorization would plainly benefit the estate and the reorganization process.

7 With such authorization, PG&E could fully satisfy the Pre-Petition Payables of  
8 eighty of the remaining QFs at the cost to the estate of no more than \$131,000. See Laszlo  
9 Decl. ¶13. In so doing, the estate would satisfy a large number of claims now, rather than at  
10 confirmation, at a relatively small costs. See id. Such authorization would also benefit the  
11 estate by: (1) serving as an effective incitement for the remaining QFs to enter into the  
12 amended PPAs (which, as stated above, significantly benefit the estate), and (2) allowing the  
13 estate to avoid any pre- or post-petition interest costs on the Pre-Petition Payables. See id.

14 In this circumstances, this Court should authorize PG&E to use cash of the estate  
15 to pay pre-petition payables of the remaining QFs when the total Pre-Petition Payables for  
16 the QF is equal to or less than \$10,000, subject to the QFs waiver of any pre- or post-petition  
17 interest. See, e.g., In re Madcat Two, Inc., 120 B.R. 990, 991 (Bankr. E.D. Ark. 1990)  
18 (“Section 363(b) of the Bankruptcy Code gives the Court broad flexibility in use of cash  
19 collateral determinations”).

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III. CONCLUSION

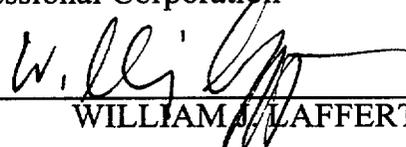
The Court should authorize PG&E to: (1) assume the PPAs with the remaining QFs on terms no less favorable to PG&E than those that this Court has already approved (subject to PG&E providing the Official Committee of Unsecured Creditors and its counsel at least 48 hour advance notice of any such assumption), and (2) pay the Pre-Petition Payables for any remaining QF whose total payables is equal to or less than \$10,000 (subject to a waiver by the QF of any right to pre- or post-petition interest).

DATED: July 30, 2001.

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Respectfully,

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