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12 PACIFIC GAS AND ELECTRIC COMPANY

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

16 In re

No. 01 30923 DM

17 PACIFIC GAS AND ELECTRIC
18 COMPANY, a California corporation,

Chapter 11 Case

19 Debtor.

Date: October 9, 2001

Time: 9:30 a.m.

Place: 235 Pine St., 22nd Floor
San Francisco, California

20 Federal I.D. No. 94-0742640

21 DECLARATION OF PAUL V. HOLTON IN SUPPORT OF PG&E'S MOTION FOR
22 ORDER APPROVING SALE OF KERN FACILITY FREE AND CLEAR OF LIENS

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26 *A001 Add: Kids Cge Mail Center*

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DECLARATION OF PAUL V. HOLTON

HOWARD
RICE
NEMEROVSKI
CANADY
FALK
& RABKIN
A Professional Corporation

HOWARD
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A Professional Corporation

1 I, Paul V. Holton, declare:
2 1. I am the Manager of the Divestiture Section in the Revenue Requirements
3 Department of Pacific Gas and Electric Company, the debtor and debtor in possession in
4 the above-captioned Chapter 11 case (the "Debtor" or "PG&E"). I submit this
5 Declaration in support of PG&E's Motion For Order Approving Sale of Kern Facility Free
6 and Clear of Liens (the "Motion"). In my above-identified capacity, I am knowledgeable
7 about and familiar with various aspects of the subject sale transaction and its history.
8 However, because the subject sale transaction is one that involves a range of employees in
9 different operational areas of PG&E, including PG&E's real estate, power generation,
10 decommissioning and regulatory functions, there is no one person within PG&E who has
11 first-hand knowledge of all of the facts described in this Declaration and the Motion. I
12 therefore have acted as an information clearing-house of sorts, putting out requests for
13 information to a number of informed employees within PG&E, and organizing and
14 collating the responses I have received to provide the composite information set forth in
15 this Declaration and the Motion. Accordingly, all of the information set forth in this
16 Declaration is either based on my own knowledge, or is based on information and belief
17 developed directly as a result of the responses I have received from informed employees of
18 PG&E respecting the requests for information that I directed to such employees. If called
19 as a witness, I could and would testify competently to the facts set forth herein based on
20 such procedure and methodology for determining such facts.

21 2. By the Motion, PG&E seeks the authority to sell free and clear of liens certain
22 real property located in Kern County, California formerly operated as a power generation
23 plant (the "Kern Facility") to North American Power Group, Ltd. ("NAPG"). The only
24 known lien on the property is the lien of BNY Western Trust Company in its capacity as
25 Trustee under the Indenture described below. The sale will result in a cash payment to
26 PG&E of \$550,000, plus, for all practical purposes as a by-product of the sale transaction,
27 the transfer from PG&E to NAPG of at least approximately \$8 million in liabilities
28 associated with the Kern Facility. In addition, NAPG has agreed to refurbish and restart a

1 non-operational power plant located on the property, thereby increasing the supply of
2 electricity available to California consumers.

3 Overview

4 3. Prior to PG&E's Chapter 11 filing, PG&E applied to the California Public
5 Utilities Commission ("CPUC") for authorization to sell the Kern Facility pursuant to
6 applicable provisions of the California Public Utilities Code. Despite the significant
7 benefits of the proposed transaction to PG&E, the CPUC refused to authorize the sale.
8 PG&E formally requested reconsideration of that decision on the grounds that it was
9 erroneous as a matter of law and unjustified as a matter of public policy. While such
10 reconsideration request remained pending, and with no action having been taken on it by
11 the CPUC for several months, California Governor Gray Davis on July 30, 2001 issued
12 Executive Order No. D-44-01 (the "Executive Order"), which vacates the CPUC's
13 decision and authorizes the sale of the Kern Facility on certain conditions specified in the
14 Executive Order as described more fully below, including the approval of this Court. A
15 true and correct copy of the Executive Order is attached hereto as Exhibit A.

16 The Property

17 4. The Kern Facility is located in Bakersfield, California. It was the site of a power
18 plant that was built in 1945-50. PG&E operated the plant from 1948 to 1985, when
19 PG&E placed the plant in cold stand-by due to the availability of less expensive sources of
20 energy and capacity. The plant was in cold stand-by until 1994, when the generation
21 production assets were retired from PG&E's books and the plant was shut down. All
22 operational permits associated with the plant have long since expired. The property to be
23 sold consists of approximately 124 out of 155 acres of land owned by PG&E at the site.
24 The Kern Facility, like PG&E's other generating facilities, was built as an integrated
25 utility facility, and the site therefore contains a mixture of generation, transmission and
26 distribution assets. Thus, PG&E will retain approximately 31 acres that are associated
27 with existing transmission and distribution assets at the site and for probable expansion of
28 substations within the next 10 years. PG&E also will retain certain easements on or

1 respecting some portion of the 124 acres to be sold, which easements are necessary for
2 PG&E's transmission substations. With such easements retained, PG&E has no need or
3 reason to maintain fee ownership of the 124 acres that are the subject of the sale.

4 The Bidding Process

5 5. Having determined that it was in PG&E's best interests for PG&E to sell the Kern
6 Facility, PG&E prior to its Chapter 11 filing employed an auction process to obtain the
7 best price from a qualified buyer. Similar auction processes have been used by PG&E and
8 approved by the CPUC on previous occasions in connection with the divestiture of
9 generation assets. The Kern Facility auction was advertised in the Wall Street Journal and
10 in letters to 300 power companies and real estate developers. These entities had either
11 expressed interest in the property or were identified as potential purchasers. Interested
12 bidders were required to submit a statement of financial and operational qualifications,
13 including audited financial statements, with an explanation how the purchase would be
14 financed, among other items of information. PG&E then provided a Confidential
15 Memorandum and form of Purchase and Sale Agreement to all qualified bidders, which
16 provided an overview of the Kern Facility and the required contractual provisions.

17 6. All qualified bidders were eligible to submit bids. NAPG prevailed because it
18 presented the highest bid at the auction. The terms of the sale are substantially the same as
19 those proposed to all bidders.¹ NAPG and PG&E executed the Purchase and Sale
20 Agreement on August 24, 2000, subject to CPUC approval pursuant to applicable
21 provisions of the California Public Utilities Code. (A true and correct copy of the
22 Purchase and Sale Agreement dated August 24, 2000, as amended to date, is attached
23 hereto as Exhibit B, and, as the same may hereafter be modified consistent with the
24 Motion, hereinafter is referred to as the "Purchase/Sale Agreement".)

25
26
27 ¹PG&E did not initially anticipate that the purchaser would restart and operate the
28 Kern Facility. Rather, PG&E assumed that the purchaser would develop new generation
at the site. NAPG's plans to restart the existing facility therefore required minor
amendments to the proposed Purchase/Sale Agreement, such as the agreement to move a
70 kV bus structure and certain water lines.

1 The Purchaser (NAPG)

2 7. NAPG is a privately held corporation headquartered in Englewood, Colorado.
3 NAPG subsidiaries have offices in Irvine, California. NAPG was formed in late 1992 and
4 began operations in 1993. NAPG develops, owns and operates independent or non-
5 regulated electric generation and energy-related projects in the United States and Canada,
6 and is a full member of the Western Systems Coordinating Council ("WSCC"). It
7 currently owns (alone or in partnership with others) and manages six power generation
8 facilities in California, whose combined output is approximately 158 MW. NAPG also
9 has over 900 MW of sited and fully-permitted power facilities ready for construction
10 within the WSCC region. NAPG also is the sponsor of over 300 miles of additional high
11 voltage transmission lines to improve WSCC reliability. NAPG has no relationship to
12 PG&E or its officers.

13 The Purchase/Sale Agreement

14 8. Under the terms of the Purchase/Sale Agreement, the Kern Facility is being sold
15 "as is." NAPG will bear the costs and risks of restarting the facility, including a major
16 refurbishment of the power plant. As with PG&E's other generation asset divestitures,
17 PG&E will retain its existing environmental liabilities for soil and groundwater
18 contamination to the extent caused by PG&E's operations on the site.

19 9. The sales price is \$550,000 cash. Further, in connection with the Purchase/Sale
20 Agreement, NAPG for all practical purposes is assuming non-environmental
21 decommissioning obligations for the Kern Facility² of approximately \$8 million.³ In
22

23 ²Although this is a quite complicated regulatory and accounting area, generally
24 stated "non-environmental decommissioning obligations" are the estimated costs to tear a
25 plan down and haul the parts and materials away. They do not include the costs of any
26 environmental remediation.

27 ³PG&E has accrued approximately \$10 million for non-environmental
28 decommissioning expenses for the Kern Facility as of July 2000. Upon completion of the
29 sale, this amount will be credited to the Transition Cost Balancing Account ("TCBA").
30 While this \$10 million benefit is not a source of cash, it is a reduction to a future liability
31 that PG&E would have had absent the sale of the Kern Facility and therefore is of
32 substantial benefit to PG&E and its bankruptcy estate. Approval of the sale will free up
33 these reserves for other uses.

1 addition, as described in more detail in the Purchase/Sale Agreement, PG&E retains
2 responsibility only for environmental costs attributable to any hazardous substances
3 released by PG&E and present on the site as of the closing; NAPG is assuming any other
4 environmental costs.⁴

5 The CPUC's Refusal To Authorize The Sale

6 10. The proposed sale of the Kern Facility was the subject of proceedings before
7 the CPUC prior to the filing of this Chapter 11 case.

8 11. As a result of AB 1890, PG&E sold its fossil generation assets through an
9 auction process approved by the CPUC. Similar to those sales, PG&E filed an application
10 to sell the Kern Facility with the CPUC on May 15, 2000, pursuant to California Public
11 Utilities Code Sections 367(b) and 851. Attached hereto as Exhibit C is a true and correct
12 copy of such application filed by PG&E. The application described the competitive
13 auction process that PG&E would use to obtain the best value and divest itself of the Kern
14 Facility, consistent with the requirements of AB 1890.

15 12. The Office of Ratepayer Advocates ("ORA") did not oppose the application.
16 At the time of the filing, PG&E already had notified potential bidders of its intention to
17 auction the Kern Facility as a non-operating generation facility. PG&E indicated in the
18 filing that it began providing the Confidential Information Memorandum and
19 Purchase/Sale Agreement to bidders on April 17, 2000 and final bids were expected by
20 July 21, 2000. The Purchase/Sale Agreement was expected to be executed in August
21 2000. Consistent with usual practice, PG&E would then file a Supplemental Filing
22 announcing the results of the auction and winning bidder upon execution of the
23

24 ⁴The Purchase/Sale Agreement may need to be amended in various technical
25 respects prior to closing, which are either technical and non-material, or beneficial to
26 PG&E. For example, the Purchase/Sale Agreement will be amended to include the
27 requirement in the Executive Order that NAPG enter into cost-based contracts for five
28 years to sell the power produced at the Kern Facility. As another example, PG&E may
update the disclosure section to include some recent development related to environmental
conditions at the plant site. The Purchase/Sale Agreement and sale transaction that PG&E
ask this Court to approve by this Motion includes the Purchase/Sale Agreement and
transaction as amended by such amendments, and PG&E by this Motion seeks the
authority to proceed to document and execute such amendments.

1 Purchase/Sale Agreement.

2 13. On December 13, 2000, PG&E filed its Supplemental Filing announcing NAPG
3 as the winning bidder and indicating the intent of NAPG to restart the Kern Facility.
4 Although PG&E and NAPG executed the Purchase /Sale Agreement on August 24, 2000,
5 PG&E had to develop an Amendment to the Purchase/Sale Agreement granting both
6 parties easements necessary for NAPG's operation of the facility. Although ORA did not
7 oppose PG&E's original application, it responded to PG&E's supplemental filing by
8 requesting that NAPG be required to sell its entire output to PG&E for at least two years
9 at a price that reflects NAPG's actual operating costs. NAPG met with ORA and
10 eventually agreed to this condition.

11 14. On March 12, 2001, the CPUC issued a draft Decision. The draft Decision
12 held that the proposed sale of the Kern Facility was barred by ABX 6, which amended
13 California Public Utilities Code Section 377. As amended, such Section 377 provides that
14 "no facility for the generation of electricity owned by a public utility may be disposed of
15 prior to January 1, 2006. The commission shall ensure that public utility generation assets
16 remain dedicated to service for the benefit of California ratepayers." The opinion also
17 ordered PG&E to restart the Kern Facility itself.

18 15. Both PG&E and ORA filed comments on the draft Decision, strongly
19 disagreeing with the conclusion that the sale was barred by ABX 6. In their comments,
20 they noted that it is clear from the language of ABX 6 that it was not intended to and does
21 not completely govern PG&E's divestiture of utility property through 2006. While AB
22 1890 broadly applied to "generation-related assets," ABX 6, by contrast, applies only to
23 "facilities for the generation of electricity." The intent behind AB 1890 was to allow the
24 utilities to recover "stranded costs" associated with any assets that had once been
25 associated with generation, whether or not they remained so associated. Simply stated, if
26 the California Legislature had meant ABX 6 to apply to all of the assets covered by AB
27 1890, it would have used the same language. Moreover, there is legislative history
28 indicating that ABX 6 was never intended to apply to a property such as the Kern Facility,

1 which had not been operating or producing power for many years.⁵

2 16. Moreover, PG&E and ORA demonstrated to the CPUC that PG&E did not have
3 the financial capability to restart and operate the Kern Facility. Restarting the facility
4 would have required PG&E to forego the revenue from the proposed sale and to expend
5 approximately \$50-70 million to restart the Kern Facility and millions more to operate it
6

7 ⁵The Legislature's intent in enacting ABX 6 was to require PG&E and Southern
8 California Edison to retain for a five-year period utility generation facilities that are
9 currently in use to meet retail load. The purpose of the legislation was to preclude for a
10 specified period the CPUC from approving a sale of the remaining utility generation to
11 third parties. Thus, ABX 6 amended California Public Utilities Code Section 377 to read:
12 "The commission shall ensure that public utility generation assets remain dedicated to
13 service for the benefit of California ratepayers." (Emphasis added.) Accordingly, the
14 target of ABX 6, for PG&E, was Diablo Canyon and PG&E's hydro facilities, both of
15 which are sources of power that are currently in use and, according to ABX 6, should be
16 dedicated to meeting retail load.

17 The Bill Analysis prepared by the Senate Energy, Utilities and Communications
18 Committee confirms the intended scope of the ABX 6. It states: "The generation assets in
19 question — those that are retained by the utilities — are Pacific Gas and Electric
20 Company's hydroelectric system and its Diablo Canyon nuclear plant, SCE's hydroelectric
21 system, its interest in the San Onofre nuclear plant and its interest in the Mohave coal-
22 fired plant in Arizona; and SDG&E's interest in the San Onofre nuclear plant."
23

24 The Kern Facility, by contrast, had not been used to generate electricity since
25 1985 and was removed from rate base in 1994. Thus, the Kern Facility did not currently
26 produce power for PG&E's retail customers and had not done so for over 15 years. The
27 Kern Facility also no longer held a permit for the generation of electricity from the
28 California Energy Commission. In short, the Kern Facility, having not been dedicated to
service for the benefit of California ratepayers since 1994, was not subject to the
disposition limitations in California Public Utilities Code Section 377, requiring that
currently operating generation facilities continue in utility service. The force of these
arguments was acknowledged in a second draft CPUC Decision issued on March 27,
2001, holding that Section 377 did not apply to the Kern Facility.

PG&E reserves the right to challenge the legality and constitutionality of ABX 6
as it would apply to PG&E's operating generating facilities that were removed from CPUC
regulation by operation of state law in effect prior to ABX 6. However, given the
Governor's Executive Order waiving the applicability of ABX 6 to the Kern Facility, the
issue of legislative intent as it affects the sale of the Kern Facility has been mooted.

1 on an ongoing basis. The CPUC had not provided for those expenditures in retail rates,
2 nor was PG&E able to raise the money from capital markets. Further, NAPG was better
3 positioned to restart the facility more quickly and efficiently than PG&E. In fact, NAPG
4 estimated that it could have begun operating the plant as early as Summer 2001 had the sale
5 been approved by the CPUC. Given the fact that NAPG was willing to provide the output
6 from the Kern Facility on a cost-of service basis for a period of two years, the sale clearly
7 amounted to the best option for all parties involved, including California's ratepayers.
8 Nevertheless, on April 4, 2001, the CPUC issued its final Decision holding that California
9 Public Utilities Code Section 377 precluded the sale, and ordered PG&E to restore the
10 Kern Facility to operational status as soon as possible.

11 The Govern Overturns The CPUC's Decision and Authorizes The Sale To NAPG

12 17. On April 16, 2001, PG&E filed an Application For Rehearing of Decision 01-
13 04-004. NAPG also filed a Motion for Reconsideration and Rehearing on April 16. In
14 addition, NAPG approached various legislators in an effort to resolve the issue via new
15 legislation. Although noticed several times on its public meeting agenda, the CPUC
16 delayed issuing a decision on the two applications for rehearing.⁶ The California Senate
17 and Assembly eventually passed ABX2-19 on July 12 and July 14, respectively. ABX2-
18 19 would have exempted the Kern Facility from California Public Utilities Code Section
19 377(b) and allowed the sale to NAPG to occur conditioned upon NAPG entering into a
20 contract approved by the CPUC to sell the power produced by the Kern Facility at cost-
21 based rates. However, ABX2-19 was withdrawn before Governor Davis could sign it.

22 18. Instead, on July 30, 2001, Governor Davis signed the Executive Order pursuant
23 to the California Emergency Services Act, California Government Code 8550, *et seq.*, and
24 thereby at once mooted the need for ABX2-19 and overrode the CPUC. The Executive
25 Order specifically found that "the prohibition against the sale of generation assets in Public
26 Utilities Code Section 377 . . . was not intended to apply to non-operational facilities" and
27

28 ⁶As of the date of this Declaration, the CPUC has not issued a decision addressing
the Applications for Rehearing filed by PG&E and NAPG.

1 that the "failure to transfer the Kern Power Plant to the North American Power Group for
2 operation will prevent, hinder, and delay mitigation of the effects of the energy shortage
3 emergency." (See Exhibit A). The Executive Order therefore suspended "any order or
4 decision of the PUC prohibiting or restricting PG&E from transferring its Kern Power
5 Plant. . . ." (Id.)

6 19. The Executive Order further requires that as a condition of the sale, NAPG
7 must enter into one or more contracts to sell the power generated by the refurbished Kern
8 Facility to the California Department of Water Resources ("DWR") or any other
9 creditworthy California entity for distribution to California ratepayers on a cost-of-service
10 basis for at least five years. NAPG has unambiguously indicated that it believes it can and
11 will meet this condition of the Executive Order, and has committed to engage in best-
12 efforts negotiations for such contract(s) with DWR and any other applicable entities
13 commencing promptly within five business days after this Court's entry of an order
14 approving the sale of the Kern Facility to NAPG. Finally, the Governor's Executive
15 Order appropriately provides that PG&E should obtain this Court's approval of the
16 proposed sale to NAPG.

17 20. PG&E requests that this Court approve the sale of the Kern Facility to NAPG
18 free of all liens and interests pursuant to Bankruptcy Code Section 363(f). PG&E is only
19 aware of one lien on the Kern Facility. That is the lien on substantially all assets of PG&E
20 in favor of BNY Western Trust Company in its capacity as the successor trustee (the
21 "Trustee") under that certain Indenture dated December 1, 1920 as amended to date,
22 which is the subject of that certain "Stipulation (I) Authorizing and Restricting Use of
23 Cash Collateral Pursuant to 11 U.S.C. §363 and Bankruptcy Rule 4001 and (II) Granting
24 Adequate Protection Pursuant to 11 U.S.C. §§361 and 363" entered into between PG&E
25 and the Trustee on May 9, 2001 (the "Cash Collateral Stipulation") and approved by the
26 Bankruptcy Court by its Order thereon dated the same date. As part of the Cash Collateral
27 Stipulation, the Trustee and PG&E agreed as follows:

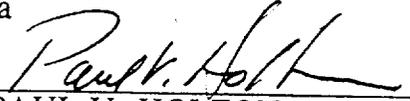
28 Except for transactions in the ordinary course of its business or

1 except as otherwise permitted in the Indenture or authorized by an
2 order of this Court (after notice to the Indenture Trustee), the Debtor
3 shall not sell, transfer, lease, encumber or otherwise dispose of any
4 Pre-Petition Collateral or Post-Petition Collateral without the prior
5 written consent of the Indenture Trustee, and no such consent shall
6 ever be implied from any other action, inaction or acquiescence by
7 the Indenture Trustee or any Bondholder. The Indenture Trustee
8 expressly authorizes the Debtor to sell assets pursuant to Section
9 363(f) of the Bankruptcy Code free and clear of any liens, claims or
10 encumbrances of the Indenture Trustee to the extent such sales are
11 permitted by the Indenture and so long as the liens, claims or
12 encumbrances of the Indenture Trustee shall attach to the proceeds of
13 such sales with the same validity and priority as the liens, claims and
14 encumbrances of the Indenture Trustee in the assets subject to such
15 sales, until the disposition of such proceeds in accordance with the
16 Indenture and applicable bankruptcy law. (Cash Collateral
17 Stipulation ¶13)

18 21. Pursuant to the Cash Collateral Stipulation, PG&E will comply with the
19 applicable provisions of the Indenture regarding the release/reconveyance of the Trustee's
20 lien on property to be sold, which in this case will result in (i) PG&E delivering a Board
21 resolution, an opinion of in-house counsel and certain certificates to the Indenture Trustee
22 pursuant to the Trust Indenture, and (ii) PG&E agreeing in escrow instructions that the net
23 proceeds of sale (i.e., the \$550,000 gross proceeds minus the direct costs of sale paid
24 through escrow) be delivered to the Trustee upon closing as a condition to the title
25 company's entitlement to rely on and record the appropriate release/reconveyance that the
26 Trustee will deliver into escrow. Further, in order to flesh out the application of the Cash
27 Collateral Stipulation to this sale and move forward with this sale with the consent of the
28 Trustee, PG&E has agreed with the Trustee (and hereby incorporates into the Motion) that
the net proceeds of the sale of the Kern Facility to be paid over to the Trustee upon closing
will be held by the Trustee in a segregated account as cash collateral for PG&E's
obligations under the Indenture, and such proceeds shall not be released to PG&E unless
and until either (i) the Trustee has consented in writing to the release of such proceeds to
PG&E, or (ii) this Court orders the Trustee to release such proceeds following a noticed
motion and hearing thereon, any such motion to be served upon the Trustee no less than
28 days prior to the scheduled hearing date. In connection with any such motion, PG&E
reserves the right to argue that the Trustee is required pursuant to the applicable provisions

1 of the Indenture to release some or all of the net proceeds of this sale that are held by the
2 Trustee as cash collateral, and/or that the Trustee's interest in PG&E's property is
3 adequately protected without regard to such cash collateral; and the Trustee reserves the
4 right to oppose any or all such arguments and to make any and all adequate protection
5 arguments that it deems appropriate.

6 I declare under penalty of perjury under the laws of the United States of
7 America that the foregoing is true and correct, and that this Declaration is executed this
8 5th day of September, 2001, at San Francisco, California

9 
10 _____
PAUL V. HOLTON

11 WD 090501/1-1419926/gff/942518/v2

12
13 HOWARD
14 RICE
NEMEROVSKI
CANADY
BALK
& RABKIN
15 A Professional Corporation

Exhibits are not attached to the service copies of this document. You may obtain copies of the Exhibits in one of the following ways: through the "Pacific Gas & Electric Company Chapter 11 Case" link accessible through the Bankruptcy Court's website (www.canb.uscourts.gov), or by written request to Howard, Rice, Nemerovski, Canady, Falk & Rabkin, Attn: Jerome Ferrer, Three Embarcadero Center, 7th Floor, San Francisco, California 94111-4065