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13 PACIFIC GAS AND ELECTRIC COMPANY

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

17 In re

Case No. 01 30923 DM

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

Chapter 11 Case

20 Debtor.

21 Date: December 21, 2001
22 Time: 1:30 p.m.
23 Place: 235 Pine Street, 22nd Floor
24 San Francisco, California

25 Federal I.D. No. 94-0742640

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MEMORANDUM OF POINTS AND AUTHORITIES IN SUPPORT OF DEBTOR'S
MOTION FOR AUTHORITY TO COMPROMISE CLAIMS BETWEEN ESTATE AND
VARIOUS QUALIFYING FACILITIES

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1 Pacific Gas and Electric Company ("PG&E" or "Debtor"), the debtor and debtor
2 in possession in the above-captioned Chapter 11 case, seeks the Court's authorization to
3 enter into a form of "Supplemental Agreement" which resolves potential disputes between
4 PG&E and various Qualifying Facilities ("QFs").

6 FACTUAL BACKGROUND

7 During July and August 2001, PG&E, with the Court's approval, has entered into
8 approximately 200 agreements to assume Power Purchase Agreements ("PPAs") between
9 PG&E and various Qualifying Facilities ("QFs"). See Declaration of Johns S. Pappas In
10 Support Of Debtor's Motion For (1) Authority To Compromise Claims Between Estate And
11 Various Qualifying Facilities; And (2) Authority To Enter Into Supplemental Agreements
12 ("Pappas Decl.") ¶2. The "Assumption Agreements" between PG&E and the QFs generally
13 provided that, *inter alia*: (a) PG&E would assume the QFs' PPAs pursuant to 11 U.S.C.
14 Section 365(b)(1) and (d)(2) and Rules 6006 and 9019 of the Federal Rules of Bankruptcy
15 Procedure; (b) the QFs would waive certain potential administrative and pre-petition claims;
16 and (c) PG&E would pay prepetition defaults (defined in the Assumption Agreements as
17 "Prepetition Payables") in an agreed amount per the terms specified in the Assumption
18 Agreements. *Id.*

19 Although the Assumption Agreements specified that interest was to be paid on
20 the Prepetition Payables, the Assumption Agreements did not specify a rate of interest. *Id.*
21 ¶3. Rather, most Assumption Agreements provided that the parties would negotiate the rate
22 of interest in good faith, and that if the parties could not agree, they would bring their
23 dispute to the Court for a determination of the rate of interest.¹ *Id.* The Assumption
24 Agreements also required PG&E to pay the prepetition default either upon the "Effective
25 Date" as defined in its Plan of Reorganization, or by installments beginning July 2003 with
26

27 ¹Most, but not all, Assumption Agreements contained these terms. For some QFs
28 whose Prepetition Payables were less than \$10,000, however, the Agreements might have
provided for an accelerated payment without interest.

1 the balance due on the Effective Date.

2 In recent weeks, PG&E and various qualifying facilities have engaged in
3 negotiations with respect to the rate and payment of interest under the Assumption
4 Agreements. Pappas Decl. ¶4. Those negotiations resulted in an agreement (documented in
5 these certain "Supplemental Agreements") with respect to the rate and payment schedule of
6 interest between PG&E and two groups of Qualifying Facilities—i.e., the Calpine group
7 ("Calpine") and the GWF group ("GWF"). *Id.*; Exs. A & B.

8 The Supplemental Agreements include the following general terms²:

- 9 (a) The outstanding principal balance of the Prepetition Payables³ shall bear
10 interest at a rate of five percent (5%) per annum (the "Interest Rate") from
11 the respective due dates of the principal amounts set forth on Attachment B
12 to the Assumption Agreements, until paid;
- 13 (b) All accrued prepetition and postpetition interest due on the Prepetition
14 Payables shall be paid on or before December 31, 2001, and thereafter, all
15 accrued interest on the outstanding unpaid principal amount of the
16 Prepetition Payables shall be payable monthly in arrears on the declining
17 balance of the Prepetition Payables until the Prepetition Payables have been
18 paid in full;
- 19 (c) Notwithstanding the terms of any plan of reorganization filed by PG&E or
20 by any other party in the Bankruptcy Case, PG&E shall pay the outstanding
21 principal balance of the of the Prepetition Payables in twelve (12) equal
22 monthly installments on the last day of each month commencing
23 December 31, 2001 and continuing on the last day of each month thereafter
24 until paid in full; and

25
26 ²The terms of the two Agreements, though substantially similar, are not identical.
They do, however, call for the same rate of interest and the same general payment schedule.

27 ³In Calpine's Supplemental Agreement, the Prepetition Payables are netted against
28 certain Prepetition Receivables owed PG&E by the QFs prior to the calculation of accrued
interest.

1 (d) If the Plan Effective Date of any plan confirmed in the case shall occur
2 before the Prepetition Payables and all interest accrued thereon has been
3 paid in full, the remaining balance of the Prepetition Payables and all
4 interest accrued thereon shall be paid on such Plan Effective Date. (Pappas
5 Decl. ¶5; Exs. A & B)

6 In addition to Calpine and GWF, several other QFs have approached PG&E
7 about entering into Supplemental Agreements on the same general terms to resolve the issue
8 of the rate of interest on the Prepetition Payables. *Id.* ¶7. Indeed, PG&E anticipates that a
9 number of QFs will seek to enter into Supplemental Agreements with identical rates of
10 interest and payment schedules. *Id.*

12 ARGUMENT

13 I.

14 THE COMPROMISES REACHED IN THE SUPPLEMENTAL AGREEMENTS ARE
15 FAIR AND EQUITABLE AND SHOULD BE AUTHORIZED PURSUANT TO
BANKRUPTCY RULE 9019.

16 A. Bankruptcy Law Favors Compromise.

17 Federal Rule of Bankruptcy Procedure 9019(a) provides that “[o]n motion by the
18 trustee and after notice and a hearing, the court may approve a compromise or settlement.”⁴
19 Indeed, Bankruptcy law favors compromises which are considered “a normal part of the
20 process of reorganization.” Protective Comm. for Indep. Stockholders of TMT Trailer Ferry
21 Inc. v. Anderson, 390 U.S. 414, 424 (1968). The Bankruptcy Court accordingly has great

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23 ⁴Although the statute specifies the “trustee,” it is clear it also encompasses
24 compromises entered into by debtors in possession. See 11 U.S.C. §1107 (“Subject to any
25 limitations on a trustee serving in a case under this chapter, and to such limitations or
26 conditions as the court prescribes, a debtor in possession shall have all the rights, other than
27 the right to compensation under section 330 of this title, and powers, and shall perform all
28 the functions and duties, except the duties specified in sections 1106(a)(2), (3), and (4) of
this title, of a trustee serving in a case under this chapter”); Wells Fargo Bank, N.A. v.
Guy F. Atkinson Co. (In re Guy F. Atkinson Co.), 242 B.R. 497, 501 (9th Cir. 1999) (“Thus,
the rule, read in combination with [11 U.S.C.] §1107, allows either the trustee or the debtor
in possession to propose settlements to the court for approval or, with prior court
authorization, to settle and compromise classes of claims”).

1 latitude in approving compromise agreements. See Martin v. Kane (In re A & C Props.),
2 784 F.2d 1377, 1380-81 (9th Cir. 1986). The Court's discretion is not, however, unlimited.
3 See Arden v. Motel Partners (In re Arden), 176 F.3d 1226, 1228 (9th Cir. 1999). The Court
4 may approve a compromise only if its "fair and equitable." Protective Comm. for Indep.
5 Stockholders of TMT Trailer Ferry Inc., 390 U.S. at 424. In evaluating any proposed
6 compromise, the Court must consider the following factors:

7 (a) The probability of success in the litigation; (b) the difficulties, if
8 any, to be encountered in the matter of collection; (c) the complexity
9 of the litigation involved, and the expense, inconvenience and delay
10 necessarily attending it; (d) the paramount interest of the creditors and
11 a proper deference to their reasonable views in the premises.
12 (Woodson v. Fireman's Fund Ins. Co. (In re Woodson), 839 F.2d 610,
13 620 (9th Cir. 1988) (quoting In re A&C Props., 784 F.2d at 1381))

14 Courts weigh these factors to determine whether the compromise is in the best interests of
15 the estate. See A & C Props., 784 F.2d at 1382 (court must "weigh certain factors to
16 determine whether the compromise is in the best interest of the bankrupt estate").

17 **B. The Factors Favor The Approval Of The Compromises Reached In The**
18 **Supplemental Agreements.**

19 The A&C Properties factors weigh in favor of authorization of the compromises
20 reached in the Supplemental Agreements.

21 To begin with, the Supplemental Agreements compromise an ongoing dispute
22 between the parties on terms more favorable than PG&E might have received if this Court
23 had to resolve the parties' interest rate dispute. It is clear that if the parties had failed to
24 reach a compromise and instead litigated the interest rate issue before this Court, they would
25 likely have advocated for widely divergent interest rates. In light of the large amounts owed
26 the compromising QFs in Prepetition Payables, the consequences of an award of interest at a
27 rate even just slightly higher than that agreed on in the Supplemental Agreements could have
28 involved the payment of additional millions of estate dollars. More specifically, the
Supplemental Agreements with Calpine and GWF resolve approximately one-third of the

1 approximately \$1 billion in outstanding QF Prepetition Payables. Accordingly, a Court
2 determination in favor of an interest rate greater than five percent (5%) would have a
3 significant impact on the estate.

4 Additionally, litigation of the interest rate dispute before this Court would
5 certainly have involved considerable expense, inconvenience and delay. This is particularly
6 true since it is unlikely that each QF would have made the exact same legal and factual
7 arguments and sought the exact same interest rate. Accordingly, the Supplemental
8 Agreements allow the estate, the QFs and the Court to avoid protracted litigation over the
9 issue of the proper rate of interest, and to put the funds that would otherwise have been used
10 for litigation to other uses.

11 Finally, the compromises reached in the Supplemental Agreements not only
12 benefit the estate and the QFs, they also benefit all creditors to the extent that they preserve
13 estate assets by: i) providing for an interest rate which is favorable to the estate by any
14 objective measure; and ii) avoiding the cost of additional litigation.

15 Accordingly, the A & C Properties factors weigh in favor of approving the
16 compromises reached in the Supplemental Agreements.

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18 II.

19 THE COURT SHOULD AUTHORIZE PG&E TO COMPROMISE SIMILAR QF CLAIMS
20 ON THE SAME TERMS WITHOUT FURTHER NOTICE OR HEARING.

21 Pursuant to Bankruptcy Rule 9019(b), after notice and hearing, the “court may fix
22 a class or classes of controversies and authorize the trustee to compromise or settle any
23 controversies within such class or classes without further hearing or notice.” See also In re
24 Guy F. Atkinson Co., 242 B.R. at 501; Boyd v. North End Auto Sales, Inc. (In re Check
25 Reporting Servs., Inc.), 137 B.R. 653, 656 (Bankr. W.D. Mich. 1992) (“This court has
26 previously authorized settlement of several classes of claims in this chapter 11 pursuant to
27 Fed. R. Bankr. P. 9019(b)”).

28 Pursuant to the authority granted it by this Court, PG&E entered into

1 approximately 200 Assumption Agreements, the vast majority of which reserved the issue of
2 interest rate and payment. In the event that PG&E and the QFs party to such Assumption
3 Agreements cannot agree on an interest rate and payment scheme, they will likely expend
4 considerable time and resources in multiple actions by individual QFs to litigate that issue
5 before this Court. Accordingly, entering into Supplemental Agreements with other QFs on
6 substantially similar terms as either Calpine or GWF is in the best interests of the estate, the
7 QFs and the Court. In addition, such Supplemental Agreements eliminate the risk to the
8 estate that the Court might award a higher rate of interest.

9 Accordingly, PG&E requests that the Court authorize it to enter into
10 supplemental agreements with QFs on substantially similar terms as the Supplemental
11 Agreements, between the filing of this motion and the hearing thereon, set for December 21,
12 2001, provided that PG&E inform the Court and interested parties at the hearing of the
13 identity of each such settling QF and the aggregate amount of prepetition payables to be paid
14 under the terms set forth in the Supplemental Agreement.

HOWARD
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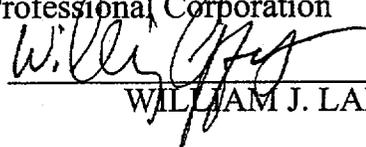
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16 CONCLUSION

17 For all of the foregoing reasons, PG&E respectfully requests that this Court grant
18 the Motion and enter and order authorizing PG&E to (1) compromise its claims against both
19 Calpine and GWF as provided by the terms of the Supplemental Agreements; and (2) enter
20 into substantially identical Supplemental Agreements with other QFs without further notice
21 and hearing.

22 DATED: December 7, 2001.

23 Respectfully,

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

26 By: 
WILLIAM J. LAFFERTY

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