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PACIFIC GAS AND ELECTRIC COMPANY

UNITED STATES BANKRUPTCY COURT  
NORTHERN DISTRICT OF CALIFORNIA  
SAN FRANCISCO DIVISION

In re

PACIFIC GAS AND ELECTRIC  
COMPANY, a California corporation,

Debtor.

Federal I.D. No. 94-0742640

Case No. 01-30923 DM

Chapter 11 Case

Date: March 25, 2002  
Time: 9:30 a.m.  
Place: 235 Pine Street  
San Francisco, California

NOTICE OF MOTION AND MOTION BY PACIFIC GAS AND ELECTRIC  
COMPANY FOR ORDER (A) APPROVING SETTLEMENT AND SUPPORT  
AGREEMENT BY AND AMONG PLAN PROPONENTS AND SENIOR  
DEBTHOLDERS, (B) AUTHORIZING PAYMENT OF PRE- AND POST-  
PETITION INTEREST TO HOLDERS OF UNDISPUTED CLAIMS IN  
CERTAIN CLASSES, (C) AUTHORIZING PAYMENT OF FEES AND  
EXPENSES OF INDENTURE TRUSTEES AND PAYING AGENTS AND  
(D) AUTHORIZING DEBTOR TO ENTER INTO SIMILAR SETTLEMENTS;  
SUPPORTING MEMORANDUM OF POINTS AND AUTHORITIES

[SUPPORTING DECLARATION OF KENT M. HARVEY FILED  
SEPARATELY]

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1 **NOTICE OF MOTION AND MOTION**

2 PLEASE TAKE NOTICE that on March 25, 2002, at 9:30 a.m., or as soon  
3 thereafter as the matter may be heard, in the Courtroom of the Honorable Dennis Montali,  
4 located at 235 Pine Street, 22nd Floor, San Francisco, California, Pacific Gas and Electric  
5 Company, the debtor and debtor-in-possession in the above-captioned case ("PG&E" or the  
6 "Debtor"), will and hereby does move the Court (the "Motion") for entry of an order  
7 (a) approving that certain Settlement and Support Agreement dated February 12, 2002 (the  
8 "Settlement Agreement"), by and among the Debtor, PG&E Corporation (the "Parent" and,  
9 together with the Debtor, the "Plan Proponents") and the Senior Debtholders,<sup>1</sup>  
10 (b) authorizing the Debtor to make payments of Pre-Petition Interest<sup>2</sup> and Post-Petition  
11 Interest to the holders of undisputed Claims in certain Classes under the Plan during the  
12 Chapter 11 Case, (c) authorizing the Debtor to pay, on an on-going basis, the fees and  
13 expenses of certain indenture trustees and administrative bank or other paying agents who  
14 have a right to hold back or otherwise seek reimbursement of their fees and expenses from  
15 the beneficial holders of financial debt to whom they make distributions and (d) authorizing  
16 the Debtor to enter into additional settlement agreements with other holders of Class 5  
17 Claims on substantially similar terms as the Settlement Agreement, without the need for  
18 further Court approval.

19 A copy of the Settlement Agreement is annexed as Exhibit "A" to the  
20 accompanying Declaration of Kent M. Harvey. This Motion is made pursuant to Sections  
21 105(a) and 363(b) of the United States Bankruptcy Code, 11 U.S.C. §§101, et seq. (the

22  
23 <sup>1</sup>The term "Senior Debtholders" means: State Teachers Retirement System of Ohio,  
24 DC Water and Sewer Authority, Chandler Asset Management, Franklin Mutual Advisers,  
25 LLC, King Street Capital, M.H. Davidson & Co., L.L.C., OZF Management L.P., OZ  
26 Management, L.L.C., Pacific Investment Management Company, L.L.C., Satellite Asset  
27 Management L.P., Security Benefit Life Insurance Co., Stark Investments, Angelo  
28 Gordon & Co., the State of Tennessee, Appaloosa Management LP, Deutsche Banc Alex.  
Brown, Inc., Bankers Trust Company, Halcyon Offshore Management Company LLC, and  
Halcyon/Alan B. Slifka Management Company LLC.

<sup>2</sup>Capitalized terms not defined herein have the meanings ascribed to them in the  
Settlement Agreement or in the First Amended Plan of Reorganization under Chapter 11 of  
the Bankruptcy Code for Pacific Gas and Electric Company, dated December 19, 2001 (as  
amended from time to time, the "Plan").

1 "Bankruptcy Code") and Rule 9019(a) of the Federal Rules of Bankruptcy Procedure (the  
2 "Bankruptcy Rules"), and is based on the facts and law set forth herein, the Declaration of  
3 Kent M. Harvey, the record of this case and any admissible evidence presented at or prior to  
4 the hearing on the Motion.

5 PLEASE TAKE FURTHER NOTICE that pursuant to Rule 9014-1(c)(2) of the  
6 Bankruptcy Local Rules for the United States District Court for the Northern District of  
7 California, any written opposition to the Motion and the relief requested herein must be filed  
8 with the Bankruptcy Court and served upon appropriate parties (including counsel for each  
9 of the Debtor, the Senior Debtholders, the Office of the United States Trustee, and the  
10 Official Committee of Unsecured Creditors) at least five (5) days prior to the scheduled  
11 hearing date. If there is no timely objection to the requested relief, the Court may enter an  
12 order granting such relief without further hearing.

### 13 MEMORANDUM OF POINTS AND AUTHORITIES

#### 14 I. INTRODUCTION

15 The Senior Debtholders are a group of creditors holding approximately \$2 billion  
16 in General Unsecured Claims against the Debtor, including Commercial Paper Claims,  
17 Floating Rate Note Claims, Medium Term Note Claims, Senior Note Claims and Revolving  
18 Line of Credit Claims, each of which is classified as a Class 5 Claim under the Plan.<sup>3</sup> Soon  
19 after the filing of the Plan, the Senior Debtholders communicated to the Debtor their strong  
20 disagreement with various aspects of the treatment to be afforded such Claims under the  
21 Plan. In particular, the Senior Debtholders disagreed with the Debtor regarding the  
22 appropriate rate of interest earned on their Claims, raised concerns regarding whether the  
23 Long-Term Notes to be issued to creditors under the Plan would have a market value of par  
24 and took the position—disputed by the Debtor—that they were entitled to exercise certain  
25 subordination rights against the holders of QUIDS Claims because they were not assured of  
26 payment in full.

27  
28 <sup>3</sup>The evidentiary basis and support for the facts set forth in this Motion are contained in  
the Declaration of Kent M. Harvey filed concurrently herewith.

1 In an effort to avoid costly and time-consuming litigation over these disputed  
2 issues, the Senior Debtholders and the Plan Proponents commenced good faith and arms-  
3 length negotiations. After months of extensive and arduous negotiations, the parties reached  
4 a compromise regarding the treatment of Senior Indebtedness. This compromise and  
5 settlement was memorialized initially in a stipulation and term sheet filed with the  
6 Bankruptcy Court on January 14, 2002, and subsequently in the Settlement Agreement for  
7 which the Debtor now seeks approval.

8 In the Settlement Agreement (which is described more fully below), the Plan  
9 Proponents have agreed to fix the principal amount of the Senior Debtholders' Claims and to  
10 make certain amendments to the Plan after the Settlement Agreement becomes effective,  
11 including, among other things, amendments relating to the rates of interest earned on Senior  
12 Indebtedness and altering certain terms of the Long-Term Notes to enhance their value and  
13 transferability. In addition, the Plan Proponents have agreed, subject to this Court's  
14 approval, to pay the reasonable fees and expenses of the Senior Debtholders and to make  
15 payments of accrued and unpaid Pre-Petition Interest and Post-Petition Interest to the Senior  
16 Debtholders during the Chapter 11 Case. In consideration of the Plan Proponents'  
17 agreements, the Senior Debtholders have agreed to support confirmation of the Plan,  
18 including voting their Allowed Claims in favor of the Plan, subject to certain conditions.

19 As noted above, the compromise memorialized in the Settlement Agreement is  
20 the product of months of extensive negotiations among the parties. The settlement  
21 negotiations were difficult, not only because of the number of parties involved—18 creditors  
22 are party to the Settlement Agreement—but also because these creditors had diverse  
23 interests, depending upon the particular debt instrument(s) they hold. Notwithstanding these  
24 diverse interests, the parties were able to reach accord on the terms of a settlement, the  
25 benefits of which were intended for all holders of Senior Indebtedness and, in some cases,  
26 all holders of Class 5 Claims. Moreover, the Settlement Agreement now provides the  
27 framework for additional settlements with other creditors.

28 The Debtor has weighed carefully the benefits afforded to the estate by the

1 settlement against the expense, risks and delays attendant to litigation over the interest rate  
2 and QUIDS Claim subordination issues and, in the exercise of its business judgment, has  
3 concluded that the settlement terms are fair and reasonable and are in the best interests of the  
4 estate in that they reflect:

- 5 a. the inherent risks of litigation;
- 6 b. the expense that would be incurred in protracted litigation  
7 between the Senior Debtholders and the Plan Proponents and the  
8 holders of QUID Claims over certain of these issues and the  
likely delays such litigation would cause in the administration of  
the estate and prosecution of the Plan; and
- 9 c. the benefits that will be afforded to other creditors who are not  
10 parties to the Settlement Agreement but who will nevertheless  
11 receive favorable treatment based on the terms thereof, including  
the contemplated Plan amendments and the Debtor's proposal to  
12 make current interest payments to holders of certain undisputed  
Claims.

13 The Debtor also seeks authorization from this Court to make current interest  
14 payments to the holders of undisputed Claims (other than Administrative Expense Claims,  
15 Environmental, Fire Suppression and Tort Claims and Chromium Litigation Claims<sup>4</sup>) after  
16 the Settlement Agreement becomes effective.<sup>5</sup> The Debtor submits that payment of Pre-  
17 Petition Interest and Post-Petition Interest is warranted under the exceptional circumstances  
18 of this Chapter 11 Case. The Debtor, a solvent entity, will have to make these payments  
19 eventually pursuant to a plan of reorganization. Currently, the estate is incurring  
20 unnecessary interest expense because the rates at which the Debtor must accrue and  
21 compound accrued interest are significantly higher than the rates the Debtor can earn on its  
22 invested cash in today's financial markets. Payment of current interest to the holders of  
23 undisputed Claims thus will have a twofold benefit: it will reduce this negative arbitrage,

24 \_\_\_\_\_  
25 <sup>4</sup>These Claims do not earn interest under the Plan. See Plan §4.1. Accordingly, these  
26 Claims are not included in the Classes of Claims for which the Debtor seeks authorization to  
pay interest pursuant to this Motion.

27 <sup>5</sup>There are three conditions to effectiveness of the Settlement Agreement: (a) Court  
28 approval of the Settlement Agreement, (b) Court approval of the Disclosure Statement and  
(c) entry into the Settlement Agreement or substantially similar agreements by the holders of  
at least \$3 billion in Class 5 Claims.



1 thus enhancing the value of the estate, and at the same time relieve creditors of some of the  
2 financial burdens they have suffered as a result of this bankruptcy.

3 Finally, the Debtor seeks authorization to pay the fees and expenses of certain  
4 indenture trustees and administrative bank and other paying agents to ensure full payment,  
5 without holdback, is made to the beneficial holders of financial debt, and to enter into  
6 similar agreements with other creditors, without the need for further Court authorization.

7 The Debtor respectfully urges this Court to approve the settlements embodied in  
8 the Settlement Agreement and grant the related relief described herein as fair and equitable  
9 and in the best interests of this estate and its creditors.

## 10 II. FACTUAL BACKGROUND

### 11 A. General Background.

12 On April 6, 2001, PG&E filed a voluntary petition for relief under Chapter 11 of  
13 the Bankruptcy Code. PG&E continues to manage and operate its businesses and properties  
14 as a debtor-in-possession, pursuant to Sections 1107 and 1108 of the Bankruptcy Code.

15 On December 19, 2001, the Plan Proponents filed the Plan. The General  
16 Unsecured Claims which are classified in the Plan as Class 5 Claims include, among others,  
17 Commercial Paper Claims, Senior Note Claims, Medium Term Note Claims, Floating Rate  
18 Note Claims and Revolving Line of Credit Claims, also referred to herein as "Senior  
19 Indebtedness." The Plan, as it has been subsequently amended, currently proposes to pay  
20 each holder of an Allowed Class 5 Claim: (a) Pre-Petition Interest and Post-Petition Interest  
21 accrued and unpaid up to the Effective Date, (b) Cash equal to 60% of the remaining  
22 Allowed Claim after the payment of Pre-Petition Interest, (c) Long-Term Notes equal to  
23 40% of the remaining Allowed Claim, and (d) a pro rata share of a \$40 million placement  
24 fee (equal to approximately 1.5% of the Long Term Notes to be issued under the Plan) to be  
25 divided among the holders of Allowed Claims in certain Classes. Plan, §4.14. The Plan  
26 further states that, unless otherwise provided in the Plan, Post-Petition Interest on Allowed  
27 Claims entitled to such interest under the Plan will be calculated and paid at the lowest non-  
28 default rate and in accordance with the terms specified in the applicable indenture or

1 instrument governing the Allowed Claims, or if no instrument exists or if the applicable  
2 instrument does not specify a non-default rate of interest, at the Federal Judgment Rate in  
3 existence as of the Petition Date. Plan, §4.1.

4 As noted above, the Senior Debtholders, who hold approximately \$2 billion in  
5 Class 5 Claims (primarily Senior Indebtedness), disagreed with the interest rates proposed to  
6 be paid on Senior Indebtedness and other elements of the treatment of these Claims under  
7 the Plan. Although the parties began good faith settlement discussions shortly after the  
8 original version of the Plan was filed on September 20, 2001, they were not able to reach an  
9 immediate agreement. On November 27, 2001, the Senior Debtholders filed an objection to  
10 approval of the Disclosure Statement in which they challenged, among other things, the  
11 interest rates to be paid under the Plan, expressed concern about the value of the Long-Term  
12 Notes and asserted that they were entitled to exercise certain subordination rights against the  
13 holders of QUIDS Claims. On January 10, 2002, the Senior Debtholders filed a second  
14 objection to the Disclosure Statement.

15 The Plan Proponents and the Senior Debtholders continued negotiations and  
16 ultimately reached an agreement in principle. On January 14, 2002, the parties executed and  
17 filed with the Court a Stipulation (including a term sheet attached thereto), pursuant to which  
18 the Senior Debtholders withdrew their objections to the Disclosure Statement, subject to the  
19 parties entering into a definitive settlement agreement incorporating the terms of the  
20 settlement.

21 B. The Settlement Agreement.

22 On February 12, 2002, the Plan Proponents entered into the Settlement  
23 Agreement. The Settlement Agreement, which is the result of months of extensive, good  
24 faith negotiations among the parties, resolves a number of disputes regarding the Senior  
25 Debtholders' Claims, including, among others, disputes over (a) the principal amount of the  
26 Class 5 Claims held by the Senior Debtholders, (b) the rate of interest earned on such  
27 Claims, (c) the amount of the placement fee to be distributed to holders of Allowed Claims  
28 in certain Classes under the Plan (including the Senior Debtholders), (d) the Cash payments

1 to be made to holders of Allowed Claims and (e) certain terms of the Long-Term Notes to be  
2 distributed under the Plan.

3 Under the Settlement Agreement,<sup>6</sup> the principal amount of the Class 5 Claims  
4 held by the Senior Debtholders will be fixed at the full face amount of the underlying  
5 financial instruments that they hold. Settlement Agreement, §1.<sup>7</sup> Upon the effectiveness of  
6 the Settlement Agreement, the Plan Proponents have agreed to amend the Plan to provide  
7 that the interest rate for Class 5 Claims will be the interest rate applicable to such Claims on  
8 the Petition Date.<sup>8</sup> *Id.*, §2(a). In addition, the Plan Proponents have agreed to make the  
9 following amendments to the Plan:

10 a. Step-up Interest Rates. The base interest rates earned on  
11 Senior Indebtedness will increase on a going-forward basis if the Plan  
12 does not become effective by certain dates, as follows: (i) 37.5 basis  
13 points on February 15, 2003; (ii) an additional 37.5 basis points on  
14 September 15, 2003; and (iii) an additional 37.5 basis points on  
15 March 15, 2004. The Debtor is not required to accrue or pay any  
16 increased interest rates for any interest accruing prior to February 15,  
17 2003. Settlement Agreement, §2(b).

18 b. Placement Fee. The placement fee to be distributed on a  
19 pro rata basis on the Effective Date to holders of Allowed Claims in  
20 Class 5 and the holders of Allowed Claims in certain other Classes (as

21 <sup>6</sup>A general description of the Settlement Agreement follows. For a more detailed  
22 understanding of all of the terms of the settlement, reference should be made to the  
23 Settlement Agreement, a copy of which is attached as Exhibit "A" to the Harvey  
24 Declaration.

25 <sup>7</sup>The Settlement Agreement provides that the amount of each Senior Debtholder's  
26 Allowed Claim will be stated on Schedule A-1 to the Settlement Agreement, and will be  
27 treated as confidential, with certain exceptions. Settlement Agreement §1. The Schedule  
28 will be prepared no later than three days prior to the hearing on this Motion, and will set  
forth the Senior Debtholders' Claims as of the date thereof. Debtor will separately bring a  
motion seeking to file Schedule A-1 under seal, pursuant to the procedures set forth in the  
Court's Case Management Order (revised June 14, 2001).

<sup>8</sup>For example, the base interest rates earned on the following types of Class 5 Claims  
will be fixed at the contract rate in existence for such Claims on the Petition Date, as  
follows: (i) Commercial Paper Claims—7.466% per annum; (ii) Floating Rate Note  
Claims—7.583% per annum (calculated on an actual days elapsed over 360 days, with an  
implied yield of 7.690%); (iii) Medium Term Note Claims—5.81% to 8.45% per annum or  
higher, as provided in the applicable documents governing the issuance of the particular  
Medium Term Notes; (iv) Senior Note Claims—9.625% per annum; and (v) Revolving Line  
of Credit Claims—8.0% per annum. Interest on such Class 5 Claims will be compounded  
quarterly, with the exception that the Medium Term Note Claims and the Senior Note  
Claims will be compounded semi-annually (all in accordance with the indenture or other  
documents governing the indebtedness). See Settlement Agreement, §2(a).

1 and to the extent provided in the Plan) will be increased to 2.5% of the  
2 aggregate amount of Long-Term Notes issued pursuant to the Plan and  
3 increased further by an additional 50 basis points with respect to any  
Long-Term Notes issued by ETrans and GTrans with a maturity of  
greater than ten years. Id., §5.

4 c. Effective Date Payments. Each holder of an Allowed  
5 Class 5 Claim will receive on the Effective Date of the Plan the  
6 following distributions: (i) a Cash payment equal to 60% of its  
7 remaining Allowed Class 5 Claim (after deducting any payments made  
8 to such holder prior to the Effective Date); (ii) a pro rata share of  
9 certain Excess Cash,<sup>9</sup> if any, to be distributed to holders of Allowed  
Claims in Class 5 and holders of Allowed Claims in such other  
Classes, as and to the extent the payment of Excess Cash to such  
Classes is provided for in the Plan; and (iii) Long-Term Notes equal to  
the balance of such Allowed Class 5 Claim after deducting the Cash  
payments made pursuant to clauses (i) and (ii). Id., §4.

10 d. Long-Term Notes. At least 50% of the Long-Term Notes  
11 issued by ETrans and GTrans will have a maturity of ten years. The  
12 interest rates on the Long-Term Notes and the New Money Notes  
13 issued by Gen, ETrans and GTrans will increase in an amount equal to  
the increase in the Option Adjusted Spread, quoted in the Lehman  
Brothers Electrical Utility Corporate Bond Index, over a defined  
period of time and subject to a maximum increase of 25 basis points.  
14 Id., §§6-7.

15 Additional material terms of the Settlement Agreement are:

16 a. Payment of Interest and Fees and Expenses. The Debtor  
17 has agreed, subject to the approval of the Bankruptcy Court, to make  
18 an initial payment to the Senior Debtholders of accrued and unpaid  
19 Pre-Petition Interest and Post-Petition Interest through the last day of  
20 the calendar month immediately preceding the date on which the  
21 Settlement Agreement is approved, in arrears, no later than ten days  
22 after all conditions to effectiveness of the Settlement Agreement have  
23 been satisfied; and payments of Post-Petition Interest thereafter in  
24 quarterly installments, with the last such payment to occur on the  
25 Effective Date. Such interest payments are subject to re-  
characterization as a partial payment of principal in the unlikely event  
that the Debtor is determined by a final non-appealable order of the  
Bankruptcy Court to be insolvent on a balance sheet basis or the  
Chapter 11 Case is converted to a case under chapter 7. The Debtor  
also has agreed, in consideration of the efforts of the Senior  
Debtholders in negotiating and compromising the disputes as  
memorialized in the Settlement Agreement and subject to the approval  
of the Bankruptcy Court, to pay certain reasonable fees and expenses

26 <sup>9</sup>The "Excess Cash" to be distributed on the Effective Date, if any, will equal the  
27 amount (if any) by which the Debtor's cash balance on its last month-end closing balance  
28 sheet preceding the date of the preliminary prospectus for the New Money Notes, less the  
sum of certain of the Debtor's cash requirements (all as more particularly set forth in the  
Settlement Agreement), exceeds \$500 million. See Settlement Agreement, §4.

1 of the Senior Debtholders. Settlement Agreement, §§2(c)-(e), 19.

2           b. Senior Debtholders' Plan Support. The Senior Debtholders  
3 have agreed to support confirmation of the Plan. Subject to the  
4 Settlement Agreement becoming effective and the receipt by the  
5 Senior Debtholders of a Plan and Disclosure Statement incorporating  
6 the terms of the Settlement Agreement and other solicitation materials  
7 approved by the Bankruptcy Court, each Senior Debtholder has agreed  
8 to (a) vote its Allowed Class 5 Claim(s), currently held and any  
9 acquired in the future,<sup>10</sup> in acceptance of the Plan, (b) fully support  
10 confirmation of the Plan, (c) not consent to, vote for, or otherwise  
11 support or encourage any plan of reorganization other than the Plan,  
12 (d) not take any actions to develop or formulate an alternative plan of  
13 reorganization, (e) not solicit or meet with other parties to develop or  
14 formulate an alternative plan of reorganization, and (f) not object to,  
15 delay or impede or otherwise oppose or object to the Plan or  
16 Disclosure Statement. Id., §13.

17           c. Termination Events. The obligations of the Senior  
18 Debtholders may only be terminated upon the occurrence of: (a) a  
19 material breach of the Settlement Agreement by the Plan Proponents,  
20 (b) a re-characterization of Post-Petition Interest payments as partial  
21 payments of principal, (c) the failure of the Debtor to make timely  
22 interest payments, (d) a determination by the Bankruptcy Court that  
23 the Debtor is insolvent on a balance sheet basis or the conversion of  
24 the Chapter 11 Case to a case under Chapter 7, (e) the failure of the  
25 Plan to become effective on or before June 1, 2003, (f) the voluntary  
26 withdrawal of the Plan by the Plan Proponents, or (g) the entry of an  
27 order by the Bankruptcy Court finding that the Plan is not confirmable  
28 (each, a "Creditor Termination Event"). The obligations of the Plan  
Proponents may only be terminated upon the occurrence of (a) a  
determination by the Bankruptcy Court that the Debtor is insolvent on  
a balance sheet basis or the conversion of the Chapter 11 Case to a  
case under Chapter 7, (b) the rejection of the Plan by holders of  
Allowed Class 5 Claims, (c) as to an individual Senior Debtholder, a  
breach by such Senior Debtholder of its obligation to support the Plan,  
and (d) as to all Senior Debtholders, if a breach or breaches by Senior  
Debtholders of their support obligations under the Settlement  
Agreement results in the remaining non-breaching holders of Allowed  
Class 5 Claims who are parties to the Settlement Agreement or  
substantially similar agreements constituting less than the Required  
Holders (as defined below) (each, a "Plan Proponent Termination  
Event"). Id., §14.

          d. Survival of Certain Obligations. The Debtor is required to  
accrue interest at the rates set forth in the Settlement Agreement unless  
(i) an event occurs giving rise to the re-characterization of Post-  
Petition Interest payments as partial payments of principal; (ii) a  
Senior Debtholder breaches its support obligations prior to a Creditor  
Termination Event (in which case the Debtor may cease accruing  
interest at the agreed rates only with respect to the breaching Senior

<sup>10</sup> Any additional Class 5 Claims acquired by the Senior Debtholders will be subject to the Settlement Agreement. See Settlement Agreement, §14.

1 Debtholder), or (iii) as a result of breaches of the support obligations  
2 by one or more Senior Debtholders prior to a Creditor Termination  
3 Event, the Required Holders constitute less than \$3 billion in Allowed  
4 Claims that currently are Class 5 Claims (in which case the Debtor  
5 may cease accruing interest at the agreed rates for all Senior  
6 Debtholders). The Debtor, however, may terminate payment of  
7 interest: (i) if an event occurs giving rise to the re-characterization of  
8 Post-Petition Interest payments as partial payments of principal, (ii) if  
9 a Senior Debtholder breaches its support obligations prior to a  
10 Creditor Termination Event (in which case the Debtor may terminate  
11 payment of interest only with respect to the breaching Senior  
12 Debtholder), (iii) if, as a result of breaches of the support obligations  
13 by one or more Senior Debtholders prior to a Creditor Termination  
14 Event, the Required Holders constitute less than \$3 billion in Allowed  
15 Claims that currently are Class 5 Claims (in which case the Debtor  
16 may terminate payment of interest as to all Senior Debtholders), (iv)  
17 any other Plan Proponent Termination Event occurs, or (v) as to any  
18 Senior Debtholder, if such Senior Debtholder does not support a  
19 subsequent plan of reorganization filed by the Plan Proponents. Id.,  
20 §§2, 14 and 25.

11 e. Nomination of Underwriters. Subject to the right of the  
12 Debtor to exclude any underwriter that refuses to enter into an  
13 appropriate underwriting agreement, the Senior Debtholders, in  
14 consultation with the Committee, have the right to nominate 5  
15 underwriters to participate in the marketing of the New Money Notes  
16 that correspond by issuer and maturity date or principal payment dates  
17 with the Long-Term Notes. Id., §11.

16 The Settlement Agreement will become effective only if (a) the Disclosure  
17 Statement is approved by this Court, (b) the Settlement Agreement is approved by this Court  
18 and (c) holders of Class 5 Claims, including each Senior Debtholder, holding at least \$3  
19 billion in the aggregate in Allowed Class 5 Claims have entered into the Settlement  
20 Agreement or substantially similar agreements (the "Required Holders"). Id., §21.

### 21 III. ARGUMENT

#### 22 A. The Settlement Agreement Should Be Approved.

23 Bankruptcy Rule 9019(a) empowers a bankruptcy court to approve any settlement  
24 or compromise related to a reorganization or liquidation.<sup>11</sup> Myers v. Martin (In re Martin),  
25 91 F.3d 389, 393 (3d Cir. 1996); Vaughn v. Drexel Burnham Lambert Group, Inc. (In re

26  
27 <sup>11</sup>Bankruptcy Rule 9019(a) simply states, in part, that "[o]n motion by the trustee and  
28 after notice and a hearing, the court may approve a compromise or settlement." Fed. R.  
Bankr. P. 9019(a).

1 Drexel Burnham Lambert Group, Inc., 134 B.R. 499, 505 (Bankr. S.D.N.Y. 1991). Indeed,  
2 compromises and settlements are a common and favored occurrence in bankruptcy cases  
3 because they allow a debtor and its creditors to avoid the financial and other burdens  
4 associated with litigation over contentious issues and expedite the administration of the  
5 bankruptcy estate. Protective Comm. for Indep. Stockholders of TMT Trailer Ferry, Inc. v.  
6 Anderson, 390 U.S. 414, 424 (1968); Martin v. Kane (In re A & C Props.), 784 F.2d 1377,  
7 1380-81 (9th Cir. 1986).

8 In reviewing proposed settlements, the bankruptcy court's inquiry focuses only  
9 upon whether the compromise is fair and equitable and in the best interest of the estate.  
10 TMT Trailer, 390 U.S. at 424; A & C Props., 784 F.2d at 1380-81; Nellis v. Shugrue, 165  
11 B.R. 115, 121 (S.D.N.Y. 1994). In making this determination, however, the bankruptcy  
12 court is not required to conduct a mini-trial on the merits of the underlying dispute or an  
13 independent investigation into the reasonableness of the settlement. Blair, 538 F.2d at 851;  
14 see also In re Purofied Down Prods. Corp., 150 B.R. 519, 522 (S.D.N.Y. 1993); Drexel  
15 Burnham, 134 B.R. at 505.

16 Rather, the standards for such approval have been described as lenient and  
17 intended to encourage approval of settlements in bankruptcy cases. See Purofied Down, 150  
18 B.R. at 522-23. The bankruptcy court need only canvass the legal and factual issues  
19 underpinning the compromise to ensure that the proposed settlement does not fall "below  
20 the lowest point in the range of reasonableness." Nellis v. Shugrue, 165 B.R. at 121-22  
21 (quoting In re W.T. Grant Co., 699 F.2d 599, 609 (2d Cir. 1983)); Purofied Down, 150 B.R.  
22 at 522; Official Unsecured Creditors' Comm. v. Pennsylvania Truck Lines, Inc. (In re  
23 Pennsylvania Truck Lines, Inc.), 150 B.R. 595, 598 (E.D. Pa. 1992), aff'd, 8 F.3d 812 (3d  
24 Cir. 1993); Drexel Burnham, 134 B.R. at 505. In making this determination, significant  
25 deference may be given to the informed judgment of the debtor-in-possession and its counsel  
26 that a proposed compromise is fair and equitable. Martin, 91 F.3d at 395; Nellis v. Shugrue,  
27 165 B.R. at 122; Purofied Down, 150 B.R. at 522-23; Drexel Burnham, 134 B.R. at 505.

28 Over the years, four significant criteria have been developed by the courts for

1 consideration in determining whether a proposed settlement falls below the lowest point in  
2 the range of reasonableness:

- 3 1. the probability of success on the merits;
- 4 2. the difficulties, if any, to be encountered in the matter of collection;
- 5 3. the complexity of the litigation involved, and the expense, inconvenience  
6 and delay necessarily attending it; and
- 7 4. the paramount interest of the creditors and a proper deference to their  
8 reasonable views.

9 A & C Props., 784 F.2d at 1381; see also Martin, 91 F.3d at 393; Nellis v. Shugrue, 165 B.R.  
10 at 122; Pennsylvania Truck Lines, 150 B.R. at 598. As demonstrated below, each of the  
11 applicable criteria is satisfied here.<sup>12</sup>

12 1. The Probability Of Success On The Merits.

13 The Settlement Agreement fully and finally resolves numerous disputes between  
14 the Debtor and the Senior Debtholders without the need for expensive, distracting and time-  
15 consuming litigation. The disputes resolved by the Settlement Agreement—each of which is  
16 discussed below in detail—include the amount of the Senior Debtholders’ Class 5 Claims  
17 and the appropriate interest rate to be paid on such Claims, the Senior Debtholders’  
18 contention that the Plan may afford them less than full payment of their Claims, and the  
19 Senior Debtholders’ assertion that they are entitled to exercise certain subordination rights  
20 against the holders of QUIDS Claims.

21 Although the Debtor believes that its positions have considerable merit and that,  
22 if litigated, the Debtor would have prevailed on the issues in dispute, no litigation is without  
23 risk. Further, certain of the issues raised by the Senior Debtholders have not been  
24 conclusively decided and, in some cases, have not been considered within the Ninth Circuit.  
25 Accordingly, how the Court ultimately would have ruled on these disputes is uncertain, and  
26 by resolving the disputes, the Debtor and the Senior Debtholders recognize the inherent risks

27  
28 <sup>12</sup>The second factor typically considered by courts—difficulty associated with collection—is not applicable here.



1 of litigation and the benefits of reaching a compromise, including the avoidance of  
2 significant expense and time associated with litigation.

3 The first accommodation embodied in the settlement relates to the amount of the  
4 Senior Debtholders' Claims and the interest rate to be paid on such Claims. Each of the  
5 Senior Debtholders' Allowed Class 5 Claims will be fixed at the full face amount of the  
6 underlying debt instrument. The Settlement Agreement also resolves the dispute among the  
7 parties regarding the rate of interest accrual on the Senior Indebtedness. The Senior  
8 Debtholders have asserted that they are entitled to be paid interest at the rate of 10% per  
9 annum, the legal rate specified under California state law for breach of contract. The Debtor  
10 believes, however, that the trend in bankruptcy cases in the Ninth Circuit is to award Post-  
11 Petition Interest at the Federal Judgment Rate as of the Petition Date (here, approximately  
12 4%), but provided in the Plan that Post-Petition Interest would accrue at the lowest non-  
13 default rate of interest in the agreement or instrument governing the particular Claim (rates  
14 that are generally higher than the Federal Judgment Rate as of the Petition Date) and, in the  
15 absence of such a document (or provision therein), at the Federal Judgment Rate as of the  
16 Petition Date. The Settlement Agreement reflects the parties' compromise—interest will  
17 accrue at the contract rate, fixed as of the Petition Date, with a potential for certain increases  
18 in the interest rate if the Plan does not become effective by certain dates.

19 The dispute over whether the treatment under the Plan affords payment in full to  
20 the Senior Debtholders also has been fully resolved. Although the Debtor firmly believes  
21 that the Plan provides for the payment in full of all Allowed Claims, the increase in interest  
22 rates and the agreed-upon modification of certain terms of the Long-Term Notes<sup>13</sup> puts this  
23

24 <sup>13</sup>Among the other amendments intended to enhance the value and transferability of the  
25 Long-Term Notes, the Plan Proponents have agreed that distributions to holders of Allowed  
26 Class 5 Claims will include a pro rata share of Excess Cash, if any, thus potentially reducing  
27 the amount of Long-Term Notes issued to creditors; that at least 50% of the Long-Term  
28 Notes to be issued to ETrans and GTrans will have a maturity of ten years; and that the  
interest rates on the Long-Term Notes and the Corresponding New Money Notes issued by  
Gen, ETrans and GTrans will increase in an amount equal to the increase in the Option  
Adjusted Spread, quoted in the Lehman Brothers Utility Corporate Bond Index over a  
defined period of time and subject to a maximum increase of 25 basis points.

1 issue to rest without the need for extensive litigation between the Plan Proponents and the  
2 Senior Debtholders. The foregoing compromise—under which the Senior Debtholders no  
3 longer contend that they will receive less than full payment on their Claims—also forecloses  
4 the need to litigate with the Senior Debtholders regarding the subordination issues related to  
5 the QUIDS Claims. The Senior Debtholders had asserted that unless and until their claims  
6 are paid in full, the holders of QUIDS Claims, which are contractually subordinated to the  
7 Claims of the Senior Debtholders, cannot receive any recovery on their claims. Although  
8 the Debtor believes that the treatment of the QUIDS Claims in the Plan is appropriate, this  
9 compromise settles the controversy with the Senior Debtholders without the need for costly  
10 and distracting litigation involving multiple parties.

11 2. Litigation Of The Disputed Issues Would Be Costly And Result In Delays  
12 In Administration Of The Estate.

13 As set forth above, the Settlement Agreement resolves numerous complex issues  
14 between the Debtor and eighteen creditors holding approximately \$2 billion in Class 5  
15 Claims.<sup>14</sup> In agreeing to the settlement embodied therein, the Debtor has made what it  
16 believes is an economically prudent business judgment that the estate's assets are better  
17 utilized in facilitating a settlement rather than prosecuting litigation.

18 The disputes at issue go to the heart of the Chapter 11 Case and, if left  
19 unresolved, would have resulted in extensive and costly litigation<sup>15</sup> in various contexts  
20 throughout the Chapter 11 Case, including objections to the Disclosure Statement, objections  
21 to the Senior Debtholders' Claims and ultimately, objections to confirmation of the Plan.  
22 Already, the negotiations between the Debtor and the Senior Debtholders have resulted in  
23 the filing of the Stipulation and the withdrawal of their objections to the Disclosure  
24

25 <sup>14</sup>The Settlement Agreement will become effective only if \$3 billion in Class 5 Claims  
have entered into the Settlement Agreement or similar agreements.

26 <sup>15</sup>Certain of the disputes with the Senior Debtholders might have required extensive  
27 discovery. Not only would such discovery have been expensive, it would have distracted the  
28 Debtor from, and delayed, its reorganization efforts. The Settlement Agreement resolves all  
of these issues and obviates the need for litigation that would likely delay administration of  
this estate.

1 Statement, thus saving the estate considerable litigation expenses. The Settlement  
2 Agreement resolves all outstanding issues between the Debtor and the Senior Debtholders,  
3 and commits the Senior Debtholders to support the Plan.

4 3. The Settlement Is In The Best Interests Of Creditors.

5 The last criteria considered by bankruptcy courts reviewing a proposed settlement  
6 is the paramount interest of creditors, with a deference to their reasonable views. A & C  
7 Props., 784 F.2d at 1381; Drexel Burnham, 134 B.R. at 505-06. While a creditor's objection  
8 to a proposed settlement must be given deference, it is not controlling and will not bar  
9 approval of settlements that "do not fall below the lowest point in the range of  
10 reasonableness." A & C Props., 784 F.2d at 1382; Drexel Burnham, 134 B.R. at 505.

11 The compromises reached in the Settlement Agreement will result—once the  
12 Settlement Agreement is effective—in amendments to the Plan that will benefit all holders  
13 of Senior Indebtedness and, in certain respects, substantially all unsecured creditors. For  
14 example:

- 15 a. all holders of Senior Indebtedness will benefit from the higher  
16 interest rates to be earned on such Claims;
- 17 b. certain creditors will benefit from the increased placement fee;
- 18 c. certain creditors will benefit from the enhanced terms of the  
19 Long-Term Notes; and
- 20 d. all creditors entitled to Pre-Petition Interest and Post-Petition  
21 Interest under the Plan will benefit from the current payment of  
22 interest.

23 The Settlement Agreement also benefits the estate and its creditors because it lays  
24 the framework for future settlements with other creditors and advances the administration of  
25 the Chapter 11 Case and the ultimate confirmation of the Plan. The principal objective of a  
26 Chapter 11 case is the confirmation and consummation of a plan, and the settlement with the  
27 Senior Debtholders furthers that goal.

28 The Debtor has carefully considered the risks, complexity and expense associated  
with litigation with the Senior Debtholders regarding their Claims and the treatment afforded  
to them under the Plan and the delays that would be occasioned by such litigation. In the

1 Debtor's sound business judgment, these factors—when considered with the benefits  
2 afforded the estate and its creditors by the settlement—tip the scale heavily in favor of  
3 approval of the proposed settlement as fair, reasonable and equitable and in the best interests  
4 of the estate and its constituencies. For these reasons, the Debtor believes that the  
5 Settlement Agreement should be approved.

6 B. This Court Should Authorize The Debtor To Make Payments Of Pre-Petition  
7 Interest And Post-Petition Interest To Holders Of Certain Undisputed Claims.

8 In consideration of the compromises reached and because it is in the best interest  
9 of the estate, the Debtor agreed in the Settlement Agreement to pay all accrued and unpaid  
10 Pre-Petition Interest and Post-Petition Interest to the Senior Debtholders and to continue to  
11 pay Post-Petition Interest in arrears on a quarterly basis during the Chapter 11 Case. By this  
12 Motion, the Debtor seeks authorization to provide this same benefit to all holders of Claims  
13 (other than holders of Administrative Expense Claims, Environmental, Fire Suppression and  
14 Tort Claims and Chromium Litigation Claims) to which no objection is pending.<sup>16</sup>

15 1. This Court Has Statutory Authority And Equitable Power Under Sections  
16 105(a) And 363(b) Of The Bankruptcy Code To Permit The Debtor To  
17 Make Interest Payments To Holders Of Undisputed Claims During The  
Chapter 11 Case.

18 Sections 105(a) and 363(b) of the Bankruptcy Code provide the statutory  
19 authority for the payment of Pre-Petition Interest and Post-Petition Interest to holders of  
20 undisputed Claims, as contemplated herein.

21 Section 363(b) provides that “[t]he trustee, after notice and a hearing, may use,  
22 sell, or lease, other than in the ordinary course of business, property of the estate.” Under  
23 Section 363(b), the Court may authorize a proposed use of property if it finds that the  
24 transaction represents a reasonable business judgment by the debtor. See Michigan Bureau  
25 of Workers’ Disability Comp. v. Chateaugay Corp. (In re Chateaugay Corp.), 80 B.R. 279,  
26 282 (S.D.N.Y. 1987) (authorizing pre-confirmation distribution under Sections 105(b) and  
27

28 <sup>16</sup>The Debtor reserves its right to object to any Claim on any available ground,  
notwithstanding the prior payment of interest to the holder of such Claim.

1 363(b)); see also Committee of Equity Sec. Holders v. Lionel Corp. (In re Lionel Corp.), 722  
2 F.2d. 1063, 1070-71 (2d Cir. 1983); In re Ernst Home Ctr., Inc., 209 B.R. 974, 979 (Bankr.  
3 W.D. Wash. 1997) (approval of non-ordinary course of business transaction appropriate  
4 where debtor has “articulated business justification” for the transaction). In considering a  
5 proposed use of estate property outside the ordinary course of business, the debtor’s business  
6 judgment is subject to “great judicial deference.” See DiStefano v. Stern (In re JFD Enters.),  
7 No. 99-2034, 2000 WL 560189, at \*5 (1st Cir. May 1, 2000).

8           There are sound and practical business reasons for the Debtor’s current payment  
9 of interest during the Chapter 11 Case. The Chapter 11 Case presents fairly exceptional  
10 circumstances. The Debtor is solvent. Thus, to satisfy the “best interests” test of Section  
11 1129(a)(7) of the Bankruptcy Code and confirm a plan of reorganization, the Debtor must  
12 pay post-petition interest to holders of Allowed Claims. Because, absent Court  
13 authorization, the Debtor is prohibited from making such payments during the Chapter 11  
14 Case, the Debtor must compound accrued unpaid interest at rates that are significantly higher  
15 than the interest the estate can earn on its cash investments in today’s economic climate—  
16 thus creating a negative arbitrage to the Debtor. On the other hand, current payments of  
17 interest would inure to the benefit of the estate and its creditors and prejudice no one. The  
18 Debtor has sufficient funds on hand to make the interest payments; creditors will be brought  
19 current on interest payments and paid interest on a going-forward basis; the unnecessary cost  
20 to the estate caused by this negative arbitrage will be eliminated; and in the unlikely event  
21 that the Debtor were determined to be insolvent, the Post-Petition Interest payments would  
22 be re-characterized as partial payments of principal.

23           In addition, Section 105(a) of the Bankruptcy Code grants this Court broad  
24 equitable power to “issue any order, process, or judgment that is necessary or appropriate to  
25 carry out the provisions of this title.” The purpose of Section 105(a) is “to assure the  
26 bankruptcy courts power to take whatever action is appropriate or necessary in aid of the  
27 exercise of their jurisdiction.” 2 Lawrence P. King, Collier on Bankruptcy ¶105.01, at 105-6  
28 (15th ed. rev. 2001).

1 Pursuant to Section 105(a), bankruptcy courts are granted broad authority and  
2 discretion to enforce the provisions of the Bankruptcy Code, either pursuant to specific  
3 statutory fiat or equitable common law principles. Under the doctrine of necessity, a  
4 bankruptcy court may exercise its equitable powers to authorize a debtor to pay certain pre-  
5 petition claims, even though such payment is not explicitly authorized under the Bankruptcy  
6 Code. As the court stated in In re Ionosphere Clubs, Inc., 98 B.R. 174, 175 (Bankr.  
7 S.D.N.Y. 1989):

8 “The ability of a Bankruptcy Court to authorize the payment of pre-  
9 petition debt when such payment is needed to facilitate the  
10 rehabilitation of the debtor is not a novel concept. It was first  
11 articulated by the United States Supreme Court in Miltenberger v.  
Logansport, C.&S.W.R. Co., 106 U.S. 286, 1 S.Ct. 140, 27 L.Ed. 117  
(1882), and is commonly referred to as either the ‘doctrine of  
necessity’ or the ‘necessity of payment’ rule.” (Id. at 175-76)

12 The court in that case recognized a bankruptcy court’s authority under Section 105(a) to  
13 authorize payment of certain pre-petition debt to avoid economic sanctions against the  
14 debtor that would result from nonpayment. Id.

15 Courts have established that “the Necessity Doctrine may also be used, however,  
16 to justify post-petition payment of a wide variety of other types of pre-petition claims, as  
17 long as payment of those claims will help to ‘stabilize [the] debtor’s business relationships  
18 without significantly hurting any party.’” In re UNR Indus., Inc., 143 B.R. 506, 519 (Bankr.  
19 N.D. Ill. 1992) (quoting R. Eisenberg & F. Gecker, The Doctrine of Necessity and Its  
20 Parameters, 73 Marq. L. Rev. 1, 2 (1989)), rev’d on other grounds, 173 B.R. 149 (C.D. Ill.  
21 1994). In that case, the court authorized the debtor to pay pre-petition workers’  
22 compensation claims which it found were necessary to enable the debtor to maintain its self-  
23 insurance privileges, where such self insurance would be less expensive than purchasing  
24 insurance from a third party. The court accordingly determined that such payments were in  
25 the best interests of the estate and were authorized under the necessity doctrine. See also In  
26 re Structurelite Plastic Corp., 86 B.R. 922, 931 (Bankr. S.D. Ohio 1988) (“a bankruptcy  
27 court may exercise its equity powers under section 105(a) to authorize payment of pre-  
28 petition claims where such payment is necessary to ‘permit the greatest likelihood of

1 survival of the debtor and payment of creditors in full or at least proportionately”) (citing In  
2 re Chateaugay Corp., 80 B.R. 279, 287 (Bankr. S.D.N.Y. 1987)); In re Equalnet  
3 Communications Corp., 258 B.R. 368, 369 (Bankr. S.D. Tex. 2000) (“[i]n certain cases,  
4 courts in this district have found exception to [the] general rule of nonpayment [of pre-  
5 petition claims]. These exceptions arise primarily out of common sense and the presence of  
6 legal or factual inevitability of payment”). Indeed, this Court recognized its ability to  
7 authorize the payment of pre-petition claims when it used its equitable powers to authorize  
8 the Debtor to make, inter alia, certain payments of pre-petition employee-related expenses.  
9 See, e.g., Order Granting Motion for Authority to Pay Pre-Petition Compensation and  
10 Benefits, dated April 6, 2001.

11 2. Early Payment Of Interest To Holders Of Undisputed Claims Is In The  
12 Best Interest Of The Debtor’s Estate And Creditors.

13 The Debtor has made a sound business judgment that early interest payments  
14 constitute a prudent and justified use of estate assets. As noted above, this is based on  
15 exceptional circumstances. The Debtor is solvent. Payment of post-petition interest to  
16 creditors is inevitable, as it will be required to confirm a plan of reorganization. As reflected  
17 in its Monthly Operating Reports filed herein, the Debtor has sufficient funds on hand to  
18 make payments of Pre-Petition Interest and Post-Petition Interest to holders of undisputed  
19 Claims.<sup>17</sup>

20 Significantly, the Debtor’s inability to make current interest payments has  
21 resulted (and will continue to result) in a significant cost to the estate. The Debtor’s cash  
22 currently is primarily invested in money market funds, which experienced an average annual  
23

24 <sup>17</sup>The initial interest payments on PG&E’s financial debt (“Financial Debt”) are  
25 estimated to aggregate approximately \$477 million, and projected subsequent quarterly  
26 interest payments on such Financial Debt through December 31, 2002 are estimated to  
27 aggregate approximately \$313 million. The initial interest payments on PG&E’s non-  
28 financial debt (“Non-Financial Debt”) are estimated to aggregate approximately \$157  
million and projected subsequent quarterly interest payments on such Non-Financial Debt,  
through December 31, 2002, are estimated to aggregate approximately \$57 million. As of  
December 31, 2001, the Debtor’s cash balance was \$4.22 billion, more than sufficient funds  
to make the proposed interest payments.

1 return of 2.15% during the month of December, 2001 and an average annual return of 2.00%  
2 during the month of January, 2002. At the same time, the average interest rate on Financial  
3 Debt is approximately 7.9%, and the average interest rate on Non-Financial Debt is 5.5%.  
4 Because the Debtor cannot pay this interest on a current basis absent Court approval, it must  
5 accrue and compound the accrued interest at these significantly higher rates.

6 As of March 31, 2002, the Debtor estimates that it will have accrued  
7 approximately \$477 million in interest on Financial Debt alone. Because of the  
8 compounding of interest, a nine-month delay, through December 31, 2002, in the payment of  
9 interest on Financial Debt will increase the Debtor's interest payments by approximately \$35  
10 million. At the same time, the interest PG&E will likely earn on its investment of the cash  
11 that would be used to pay accrued interest, during the period from March 31, 2002 through  
12 December 31, 2002, would offset these increased interest expenses by only an estimated \$6  
13 million. Thus, unless PG&E is allowed to make interest payments on its Financial Debt  
14 during the period from March 31, 2002 through December 31, 2002, it will suffer an  
15 unnecessary interest expense of \$29 million on Financial Debt alone. In addition, by making  
16 interest payments to the holders of Non-Financial Debt during the six month period from  
17 July 1, 2002 through December 31, 2002, PG&E will avoid incurring another \$2 million in  
18 unnecessary interest expense.<sup>18</sup> Accordingly, the early payment of interest will result in  
19 savings of approximately \$31 million during the nine-month period ending December 31,  
20 2002.

21 Significantly, since all holders of undisputed Claims in the Classes entitled to  
22 receive interest will benefit from the early interest payments, the policy concern underlying  
23 the general prohibition of pre-confirmation distributions—i.e., disparate treatment of  
24 creditors—is not implicated here. In addition, these payments do not pose any risk of harm  
25

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26 <sup>18</sup>As set forth below, PG&E proposes to commence interest payments on Non-  
27 Financial Debt no later than July 30, 2002. PG&E requires this additional time to reconcile  
28 and determine which Claims based on Non-Financial Debt are disputed before commencing  
interest payments on these Claims. Interest would continue to accrue on these Claims until  
paid.



1 to the estate. In the unlikely event that the Debtor were ever adjudged insolvent, the Post-  
2 Petition Interest payments would be re-characterized as partial payments of principal. Thus,  
3 there is no danger that any one creditor would receive more than its pro rata payment on  
4 account of its Allowed Claim.

5 For these reasons, the Debtor respectfully submits that early interest payments  
6 constitute a sound use of the Debtor's assets under Section 363 of the Bankruptcy Code and  
7 should be authorized on that basis, and pursuant to Section 105(a) of the Bankruptcy Code.

8 3. Proposed Procedure For Making Interest Payments.

9 The Debtor proposes to make the initial interest payments to holders of Financial  
10 Debt who hold undisputed Claims (including the Senior Debtholders) within ten days after  
11 all conditions to the effectiveness of the Settlement Agreement have been satisfied.  
12 Subsequent interest payments in respect of such Claims will be made in arrears on a  
13 quarterly basis on the first Business Day of the next calendar quarter.

14 With respect to Non-Financial Debt, the Debtor proposes to make initial interest  
15 payments in respect of undisputed Claims by the later of (a) July 30, 2002 and (b) ten  
16 Business Days after the entry of an order approving the Disclosure Statement. The Debtor  
17 requires this time to determine which of the thousands of claims filed in the Chapter 11 Case  
18 should be subject to objection and to prepare objections accordingly, a process that must be  
19 substantially completed before interest payments can commence.<sup>19</sup> In addition, this time  
20 will allow the Debtor to establish the administrative procedures necessary to compute the  
21 amount of Pre-Petition Interest and Post-Petition Interest that is owed and to facilitate  
22 payments to thousands of creditors.<sup>20</sup> Post-Petition Interest will continue to accrue on  
23 Allowed Claims until payments are made. Subsequent interest payments will be made

24 <sup>19</sup>As stated in the Disclosure Statement, the Debtor anticipates filing all of its  
25 objections to Disputed Claims by June 30, 2002.

26 <sup>20</sup>Because payments to holders of Financial Debt are made through an indenture trustee  
27 or administrative bank or other paying agent, this additional time is not required to make  
28 payments to the holders of Financial Debt. Thus, the Debtor has agreed, under the  
Settlement Agreement, to make the initial payment of Pre-Petition Interest and Post-Petition  
Interest to the Senior Debtholders within ten Business Days after all conditions to  
effectiveness of the Settlement Agreement have been satisfied.

1 quarterly in arrears within thirty days following the end of each calendar quarter.

2 The Debtor requests that the Court establish a record date of June 30, 2002 for the  
3 initial interest payments to the holders of undisputed Claims arising out of Non-Financial  
4 Debt and the last Business Day of each calendar quarter as the record date for subsequent  
5 interest payments to such holders. The Debtor further requests that the Court order that  
6 interest payments be made only to the record holders of such Claims on the applicable  
7 record date.

8 C. Payment Of The Fees And Expenses Of Indenture Trustees And Administrative  
9 Bank And Other Paying Agents Should Be Approved.

10 Under the Settlement Agreement, the Debtor agreed to use its reasonable best  
11 efforts to ensure that the Senior Debtholders receive a full distribution on account of their  
12 Claims, with no deduction or holdback by any indenture trustee or paying agent. See  
13 Settlement Agreement, §16(a). To satisfy this obligation, the Debtor agreed, subject to the  
14 approval of the Bankruptcy Court, to pay all costs and expenses necessary to ensure that a  
15 full distribution is made to Senior Debtholders. Id. Rather than limit this benefit to the  
16 Senior Debtholders, the Debtor seeks, subject to the procedures described below, to pay the  
17 fees and expenses of all indenture trustees and paying agents<sup>21</sup> which have a right, under  
18

19 <sup>21</sup>The indenture trustees or other paying agents whose fees and expenses would be paid  
20 are: (a) Wilmington Trust Company (successor-in-interest to The Bank of New York), as  
21 indenture trustee for the Floating Rate Notes, the Medium Term Notes and the Senior Notes,  
22 all issued under the indenture dated as of September 1, 1987 between the Debtor and The  
23 Bank of New York, as amended and supplemented (the "1987 Indenture"); (b) The Bank of  
24 New York, the former indenture trustee under the 1987 Indenture; (c) Bankers Trust  
25 Company (Deutsche Bank), in its capacity as trustee for the 1992 Series A Pollution Control  
26 Bonds, 1996 Series C Pollution Control Bonds, 1996 Series E Pollution Control Bonds,  
27 1996 Series F Pollution Control Bonds and 1997 Series B Pollution Control Bonds; (d) U.S.  
28 Bank Trust, N.A. in its capacity as trustee for the 1992 Series B Pollution Control Bonds,  
1993 Series A Pollution Control Bonds, and 1993 Series B Pollution Control Bonds;  
(e) Bank One Trust Company, N.A. (successor-in-interest to The First National Bank of  
Chicago), as property trustee under the amended and restated trust agreement dated as of  
November 28, 1995 among the Debtor, The First National Bank of Chicago, a Delaware  
Trustee and certain Administrative Trustees; (f) National City Bank of Indiana (successor-  
in-interest to Bank One Trust Company, N.A.), indenture trustee for the QUIDS, issued  
under the indenture dated November 28, 1995, as supplemented as of November 28, 1995  
and March 25, 1996; and (g) Bank of America National Trust and Savings Association, as  
administrative agent and documentation agent for the Debtor's Revolving Line of Credit.

1 governing agreements or instruments, to deduct their fees and expenses from distributions to  
2 beneficial holders or otherwise to seek reimbursement from the beneficial holder of  
3 Financial Debt, so that all such creditors will receive full payment.

4 Unless the Debtor agrees to pay such costs, each of the paying agents and trustees  
5 would likely deduct their costs and expenses from the amounts which will be paid to holders  
6 of undisputed Financial Debt. Given the relatively modest cost of covering these fees and  
7 expenses—current outstanding amounts are estimated to be approximately \$3 million—the  
8 Debtor seeks the Court's authorization to pay these fees and expenses. The Debtor also  
9 requests that it be authorized to continue to pay such fees and expenses on an on-going basis.

10 The Debtor proposes that the same procedures established for the payment of fees  
11 and expenses of BNY Western Trust Company, as indenture trustee for certain mortgage  
12 bonds, in the Cash Collateral Stipulation, approved by this Court on May 9, 2001, be utilized  
13 in connection with payments to indenture trustees and other paying agents as well as for  
14 payment of the fees and expenses of the Senior Debtholders, as provided in the Settlement  
15 Agreement:

- 16 (1) Any indenture trustee, administrative bank, other paying agent or  
17 Senior Debtholder seeking reimbursement of its fees and  
18 expenses will be required to serve copies of its invoices and the  
19 invoices of any professionals it has retained upon the Debtor, its  
20 counsel, counsel to the Committee and the United States  
21 Trustee's Office.
- 22 (2) If any such party believes that all or a portion of the amounts  
23 reflected in any invoice are unreasonable (an "Objecting Party"),  
24 such Objecting Party will be required to provide written notice  
25 thereof to such Senior Debtholder, indenture trustee,  
26 administrative bank or other paying agent, or the applicable  
27 professional, within 20 days of the receipt of the invoice in  
28 question (with a copy to the Debtor and its counsel).
- (3) Promptly after the expiration of such 20-day period, the Debtor  
will pay any undisputed portion of such invoices, and retain the  
balance thereof pending resolution of any dispute with an  
Objecting Party, or, if any such dispute cannot be consensually  
resolved, upon approval of any disputed portion by this Court.
- (4) The payment of any fees and expenses of any indenture trustee,  
administrative bank, other paying agent or Senior Debtholder  
will be expressly subject to disallowance by the Court.

1 The Debtor respectfully submits that the payment of fees and expenses of Senior  
2 Debtholders, indenture trustees, administrative bank or other paying agents as provided  
3 herein should be authorized as a necessary corollary to the payment of interest.

4 D. The Debtor Should Be Authorized To Enter Into Substantially Similar  
5 Settlements Without Further Court Approval.

6 Finally, the Debtor seeks authorization to enter into additional settlement  
7 agreements with other holders of Allowed Class 5 Claims on substantially the same terms as  
8 the Settlement Agreement,<sup>22</sup> without the burden and expense of seeking further Court  
9 approval of such settlements.

10 It is well-established that where numerous settlements are anticipated, the court in  
11 its discretion may grant the debtor-in-possession authority to settle under Rule 9019(b)  
12 within appropriate parameters without requiring that each and every potential settlement be  
13 set for hearing. See 10 Collier on Bankruptcy, supra, ¶9019.03, at 9019-5 to 9019-6.

14 Indeed, this Court recognized its authority to authorize settlements without having each  
15 individual settlement brought before the Court when it authorized the Debtor to enter into  
16 settlements of disputed Claims within certain parameters. See Order on Debtor's Motion for  
17 Authorization to Settle Certain Pre-Petition Claims, dated January 3, 2002.

18 Absent advance approval by the Court to enter into additional agreements with  
19 creditors that are substantially similar to the Settlement Agreement, the Debtor would be  
20 required under Bankruptcy Rule 9019 to seek this Court's approval of each such subsequent  
21 settlement. The Debtor submits that it would be wasteful for the Debtor and burdensome for  
22 the Court to review repeated motions seeking approval of settlements that are on  
23 substantially the same terms already approved by this Court. To avoid this waste of estate  
24 and judicial resources, the Debtor respectfully requests that the Court authorize the Debtor to  
25 enter into future settlements on substantially the same terms as the Settlement Agreement  
26

27 <sup>22</sup>A condition to effectiveness of the Settlement Agreement is that holders of Allowed  
28 Class 5 Claims aggregating at least \$3 billion must be party to the Settlement Agreement or  
substantially similar agreements. Settlement Agreement, §21.

1 without further Court approval.

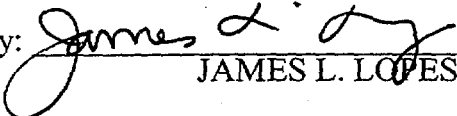
2 **CONCLUSION**

3 For all the foregoing reasons, the Debtor respectfully requests that this Court  
4 make and enter an order that (a) approves the Settlement Agreement, (b) authorizes the  
5 payment of Pre-Petition Interest and Post-Petition Interest to the holders of undisputed  
6 Claims specified herein, (c) authorizes the Debtor to bring current and to pay, on an on-  
7 going basis, the fees and expenses of indenture trustees and paying agents specified herein  
8 and (d) authorizes the Debtor, without further approval from this Court, to enter into future  
9 settlement agreements with other creditors on substantially similar terms as the Settlement  
10 Agreement.

11  
12 DATED: March 5, 2002.

13 Respectfully,

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

16  
17 By:   
JAMES L. LOPES

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