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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: May 9, 2002 Time: 1:30 p.m. Place: 235 Pine Street, 22nd Floor San Francisco, California

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NOTICE OF MOTION AND MOTION FOR ORDER AUTHORIZING EXPENDITURES RELATED TO PERMITS AND FRANCHISES; MEMORANDUM OF POINTS AND AUTHORITIES IN SUPPORT THEREOF

[Supporting Declarations of Richard Meiss and Terry Morford Filed Concurrently Herewith]

A001 Add: Kids Oge Mail Center

NOTICE OF MOTION AND MOTION

PLEASE TAKE NOTICE that on May 9, 2002, at 1:30 p.m., or as soon thereafter as the matter may be heard, in the Courtroom of the Honorable Dennis Montali, located at 235 Pine Street, 22nd Floor, San Francisco, California, Pacific Gas and Electric Company, the debtor and debtor in possession in the above-captioned Chapter 11 case ("PG&E"), will and hereby does move the Court for entry of an Order Authorizing Expenditures Related to Permits and Franchises (the "Motion").

This Motion is based on this Notice of Motion and Motion, the accompanying Memorandum of Points and Authorities, the Declarations of Richard Meiss and Terry Morford filed concurrently herewith, the record of this case and any evidence presented at or prior to the hearing on this Motion.

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

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MEMORANDUM OF POINTS AND AUTHORITIES

Pacific Gas and Electric Company, the debtor and debtor in possession in the above-captioned Chapter 11 case ("PG&E"), requests an order authorizing PG&E to incur and pay certain permit and franchise-related expenses outside of the ordinary course of business pursuant to Bankruptcy Code Section 363(b)(1).

I. FACTUAL BACKGROUND[1]

PG&E filed a voluntary petition for relief under Chapter 11 of the Bankruptcy Code on April 6, 2001. A trustee has not been appointed, and PG&E continues to function as a debtor-in-possession pursuant to Sections 1107 and 1108 of the Bankruptcy Code.

On March 7, 2002, PG&E, together with its parent corporation, PG&E Corporation, filed a proposed Second Amended Plan of Reorganization (as amended from time to time, the "Plan"). The Court tentatively approved the Second Amended Disclosure Statement for the Plan after hearing conducted on April 11, 2002, subject to final approval at the hearing scheduled for April 24, 2002.

The Plan generally provides for the creation of three new companies, ETrans LLC, GTrans LLC and Electric Generation LLC[2] (collectively, the "New Entities"), whereby PG&E will separate its operations into four lines of business based on PG&E's historical functions: retail gas and electric distribution, electric transmission, interstate gas transmission, and electric generation. As described in more detail below, the New Entities will require certain permits, licenses and franchises in order to conduct their operations in full compliance with relevant laws, rules and regulations. By this Motion, PG&E seeks approval for certain expenses related to obtaining the necessary permits, licenses and franchises for the New Entities.

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[1]The evidentiary basis and support for the facts set forth in this Motion are contained in the Declarations of Richard Meiss and Terry Morford filed concurrently herewith.

[2]The reference to "Electric Generation LLC" herein includes the subsidiaries and affiliates of Electric Generation LLC that will hold certain generation assets.

A. Permits.

PG&E holds tens of thousands of operating and land occupancy permits, licenses and related governmental entitlements (collectively, "Permits") from local, state and federal government agencies. Approximately 12,000 of these Permits must be transferred or reissued[3] to the New Entities in order for the New Entities to conduct business operations in accordance with the law.[4]

The Plan contemplates that PG&E will follow established application procedures for the transfer of Permits under applicable local, state or federal law. Before the application process can begin, however, PG&E must complete its permits inventory and database development, which is currently in progress, along with the training of personnel who will work on the project. Many Permit transfers will involve only ministerial review by the government agency, which typically takes several weeks to process. Other Permit transfers will involve discretionary review and approval by the government agency, which typically takes from one to several months to process. Some Permit applications may also trigger environmental review, in which case the application process will be more complex and likely take additional time.[5]

B. Franchises.

PG&E is a party to over 520 franchise agreements with various cities and counties, which allow PG&E to install, operate and maintain its electric, gas, oil and water facilities in the public streets and roads owned by local governments. In exchange for the right to use public streets and roads, PG&E pays an annual fee to the cities and counties

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[3]For ease of reference, the transfer or reissuance of permits is referred to hereafter as "transfer".

[4]The New Entities could begin operations without a small portion of these Permits, which involve non-essential activities.

[5]If any Permits are denied by government agencies or cannot be issued on a timely basis, PG&E reserves the right to seek relief from the Court pursuant to Bankruptcy Code Section 1142(b) or other applicable bankruptcy law.

under the franchises. Franchise fees are computed according to statute depending on whether the particular franchise was granted under the Broughton Act or the Franchise Act of 1937 (the "Franchise Act"); provided, however, that the 38 "charter cities" can set a fee rate of their own determination.

Under the Plan, PG&E will retain the existing franchises,[6] and the New Entities will enter into new franchises ("Franchises") where such Franchises are necessary. For example, since ETrans LLC will be taking over PG&E's electric transmission business, Electric Generation LLC will be taking over the electric transmission ties from the hydroelectric powerhouses to the transmission grid, and GTrans LLC will be taking over PG&E's gas transmission business, the New Entities will require Franchises in order to operate where the applicable electric or gas transmission facilities are located within public streets and roads. PG&E estimates that approximately 500 Franchises will be needed.

Pursuant to either the Franchise Act or applicable charter city provisions, local governments grant public utility franchises as ordinances upon the filing and consideration of an application. Pursuant to the Franchise Act, the California Government Code and, in some cases, charter city procedures, there are minimum timetables between the filing of the application and the adoption of the franchise ordinance. Local government must hold public hearings before it may grant a franchise ordinance. The California Constitution requires that all franchise ordinances be subject to a voters' referendum, and, in some cases, charter cities may only grant franchises by popular vote at a city-wide election. While the timing varies depending on whether the general law or more specific charter city provisions govern, it can exceed six months from the time an application is submitted to the granting of the franchise ordinance.

[6]There are two exceptions: PG&E's gas franchises with Modoc County and San Bernardino County will be assumed and assigned to GTrans LLC because PG&E does not have any distribution facilities within either county and therefore does not need to retain these two franchises.

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C. Description of Permit and Franchise Work to be Completed by Contractors.

The contractors described below will assist PG&E in the process of transferring Permits and acquiring Franchises for the New Entities (the "Permit and Franchise Work"). While PG&E has in-house expertise in this area, the volume of Permit and Franchise Work and time period for completion of the work requires substantial outside assistance. The contractors described below will perform their portion of the Permit and Franchise Work at the direction of and under the supervision of PG&E.

1. Transcon Infrastructure, Inc.

Transcon Infrastructure, Inc. ("Transcon") is experienced with managing and coordinating permitting, licensing and siting efforts on a broad range of utility infrastructure projects, including coordination efforts with local, state and federal agencies. Transcon will perform the following types of services with respect to the Permit and Franchise Work: (i) project management; (ii) planning and training assistance for all PG&E team members including the Entitlement Agents described below; (iii) assistance with the transfer of the Permits and the acquisition of Franchises, including documentation; and (iv) evaluation of the procedural requirements underlying PG&E's existing permits and licenses.

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PG&E requests approval to pay Transcon approximately $950,000 (the "Transcon Budget"), over a period beginning in February 2002[7] and continuing to the Effective Date (as defined in the Plan) or such earlier date on which the Permit and Franchise Work has been completed. PG&E would pay Transcon on a monthly basis as work is completed, based on monthly billings by Transcon.

2. Entitlement Agents.

PG&E will also be utilizing 11 individuals who are employed by Corestaff Services, Inc., a staffing agency, for assistance with the Permit and Franchise Work (the "Entitlement Agents"). The Entitlement Agents will be responsible for the acquisition of

[7]Transcon began limited work in February 2002 to assist PG&E in determining the scope and timing of the work to be completed and project staffing needs.

Franchises and assisting with the transfer of Permits,[8] including (i) developing a strategy and plan for the timely acquisition of Franchises; (ii) conducting negotiations with the cities, counties and districts as necessary; and (iii) working with the cities, counties and districts in transferring the Permits. Each Entitlement Agent will be assigned to a group of 10 to 20 cities, counties and districts within a given geographical location. PG&E has chosen the Entitlement Agents based on their ability to work effectively with local governments; some have experience working in regulated industries and others have experience working in technical marketing.

PG&E requests approval to pay the Entitlement Agents approximately $3 million (the "Agent Budget"), beginning April 2002 and continuing to the Effective Date (as defined in the Plan) or such earlier date on which the Permit and Franchise Work has been completed. PG&E would pay the Entitlement Agents through Corestaff Services, Inc. on a monthly basis as work is completed, based on monthly billings by the Entitlement Agents.

PG&E believes that Transcon and the Entitlement Agents do not rise to the level of "professionals" under the Bankruptcy Code, due both to the nature of the services to be provided and to their limited role in connection with PG&E's reorganization proceeding. See In re That's Entertainment Mktg. Group, Inc., 168 B.R. 226, 230 (N.D. Cal. 1994); see also In re Saybrook Mfg. Co., Inc., 108 B.R. 366 (Bankr. M.D. Ga. 1989) (in determining whether a person is a professional for purposes of Section 327, courts consider not only the nature of the services provided but also how central the services are to the reorganization proceeding). Although the work is related to implementation of the Plan, PG&E believes that it should not be considered "central" to the Chapter 11 case or the Plan proceedings.

[8]The Entitlement Agents will assist with the Permits to be transferred by local government (including cities, counties and districts), which comprise the majority of the issuing agencies.

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D. Current Need for Approval of Budgets for Permit and Franchise Work.

The Permit and Franchise Work is essential to the implementation of the Plan. Although the Plan is not yet confirmed, PG&E estimates that it could take up to 12 months[9] to complete the Permit and Franchise Work necessary to enable the New Entities to operate their respective businesses. Therefore, given the volume of work and the time required for completion, the Permit and Franchise Work must be accelerated well in advance of confirmation of the Plan in order to assure a timely Plan consummation.

PG&E is mindful of the fact that some government agencies will be receiving an influx of Permit and/or Franchise applications, which may stretch agency resources. Thus, in assessing the need to complete the Permit and Franchise Work, PG&E is assuming that typical time periods for processing applications may be extended, particularly for agencies receiving multiple applications.

Finally, to the extent that subsequent events demonstrate that the Permit and Franchise Work will not be necessary, the work can be terminated immediately. PG&E's standard contractual provisions in place with Transcon and the Entitlement Agents (through Corestaff Services, Inc.) do not guarantee future work or any minimum amount of revenue. PG&E also maintains the right to terminate the contracts at any time without cause, in which case PG&E is liable only for work performed to the date of termination plus costs reasonably incurred by the contractor in terminating any work in progress.

II.

THE BUDGETS FOR THE PERMIT AND FRANCHISE WORK SHOULD BE APPROVED PURSUANT TO SECTION 363(b)(1) OF THE BANKRUPTCY CODE

PG&E seeks approval for the Transcon and Agent Budgets (collectively, the "Budgets") as a use of estate property that is outside of the ordinary course of business under

[9] In some instances, the timing may vary due to factors over which PG&E has no control, such as electoral approval required for a Franchise ordinance, or exercise of an agency's discretion in processing a Permit transfer application.

Bankruptcy Code Section 363(b)(1). Since the Permit and Franchise Work is related to implementation of the Plan, PG&E believes that the purpose and scope of this expenditure may be characterized as outside of the ordinary course of business and therefore requires Court approval.

The Court has considerable discretion in approving a request pursuant to Section 363(b)(1) of the Bankruptcy Code ("'[t]he trustee, after notice and a hearing, may use, sell, or lease, other than in the ordinary course of business, property of the estate"). See In re Montgomery Ward Holding Corp., 242 B.R. 147, 153 (D. Del. 1999) (affirming the bankruptcy court's decision to approve expenditure for employee incentive programs, noting that bankruptcy court has considerable discretion in approving a Section 363(b) motion).

In determining whether to authorize a transaction under Section 363(b)(1), courts require a debtor to show that a sound business purpose justifies such actions, applying the business judgment test. See, e.g., Stephens Indus., Inc. v. McClung, 789 F.2d 386, 389-90 (6th Cir. 1986); Comm. of Equity Sec. Holders v. Lionel Corp. (In re Lionel Corp.), 722 F.2d 1063, 1071 (2d Cir. 1983); see also 3 Lawrence P. King, Collier on Bankruptcy ¶363.02[1][g] (15th ed. rev. 1998).

Once the debtor has articulated a rational business justification, a presumption attaches that the decision was made "on an informed basis, in good faith and in the honest belief that the action taken was in the best interest of the [debtor]." See, e.g., Official Comm. of Subordinated Bondholders v. Integrated Res., Inc. (In re Integrated Res., Inc.), 147 B.R. 650, 656 (S.D.N.Y. 1992) (citing Smith v. Van Gorkom, 488 A.2d 858, 872 (Del. 1985)).

Here, sound business justifications exist for approval of the Budgets. The Permit and Franchise Work is necessary, PG&E does not have sufficient capacity in-house to handle the Permit and Franchise Work without the assistance of Transcon and the Entitlement Agents, and delaying the work could jeopardize PG&E's ability to timely implement the Plan.

Also, PG&E is solvent and has sufficient cash to pay the Budgets without causing any detriment to its creditors.[10] Thus, while there is the possibility that the Plan will not be confirmed and therefore the Permit and Franchise Work will become unnecessary, this does not justify denial of the expenditure. See Montgomery Ward, 242 B.R. at 154 (no requirement for debtor to show a successful prospect of reorganization in order to justify expenditure request under Section 365(b)(1)). It is sufficient that PG&E currently has sound business reasons for the expenditure. In a case of this size and complexity, it is simply not possible to wait until Plan confirmation to begin all of the work necessary to implement the Plan. Therefore, in requesting approval for the Budgets, PG&E has attempted to strike a balance between being prepared to implement the Plan and being in a position to terminate the Permit and Franchise Work at any time.

CONCLUSION

For all of the foregoing reasons, PG&E respectfully requests that the Court approve the Budgets for the Permit and Franchise Work as set forth herein and grant such other and further relief as may be just and appropriate.

DATED: April 19, 2002

Respectfully,

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

By: [signature]
JULIE B. LANDAU

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

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[10]As reflected in PG&E's February 2002 Monthly Operating Report, PG&E held more than $4.8 billion in cash reserves as of February 28, 2002.