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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: May 20, 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 AUTHORIZATION TO INCUR AND PAY CERTAIN PROCUREMENT EXPENSES; MEMORANDUM OF POINTS AND AUTHORITIES IN SUPPORT THEREOF

[Supporting Declaration of Ronald Battles Filed Concurrently Herewith]

Add'l
Add'l: Rick Ogo Mail Center

NOTICE OF MOTION AND MOTION

PLEASE TAKE NOTICE that on May 20, 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 PG&E to Incur and Pay Certain Procurement Expenses (the "Motion").

This Motion is based on this Notice of Motion and Motion, the accompanying Memorandum of Points and Authorities, the Declaration of Ronald Battles 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 procurement 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.

PG&E is an investor-owned utility providing gas and electric services to more than 4.5 million customers in central and northern California serving a total population of about 13 million. PG&E employs over 19,000 people and has in excess of 30,000 trade creditors.

On April 19, 2002, PG&E, together with its parent corporation, PG&E Corporation, filed its amended Plan of Reorganization (as amended from time to time, the "Plan"). The Court approved the Disclosure Statement for the Plan after hearing conducted on April 24, 2002.

A. <u>Necessity for New Procurement Contracts</u>.

The Plan generally provides for the creation of three new companies, ETrans LLC, GTrans LLC and Electric Generation LLC (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.

PG&E holds approximately 3,500 contracts for goods and services, including, for

[1]The evidentiary basis and support for the facts set forth in this Motion are contained in the Declaration of Ronald Battles filed concurrently herewith.

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example, contracts for wood pole replacement, tree trimming and brush removal, facility construction and maintenance, and software license agreements. Many of the goods and services represented by these contracts are essential to day to day operations and generally require a vendor's specialized knowledge or equipment. A majority of these contracts service a single line of business and will either be retained by the Reorganized Debtor or assigned to one of the New Entities. However, approximately 1,200 of PG&E's existing contracts represent goods and services that are currently shared among two or more of the business lines. In most cases, the existing "shared" contract will be retained by the Reorganized Debtor; in a limited number of cases, the existing "shared" contract will instead be assigned to the New Entity that represents the largest user of the applicable goods or services. As a result, the New Entities (and in a limited number of cases, the Reorganized Debtor) will need approximately 1,200 new contracts ("New Contracts") for the goods and services that are currently shared.

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PG&E's typical procurement process involves the solicitation of competitive bids from three or more pre-qualified vendors. The vendor qualification process may involve one or more of the following: verification of a potential vendor's experience and quality through reference checks, a financial assessment of potential vendors, manufacturing plant site inspections and sample product analysis. After vendors have been pre-qualified, PG&E develops specifications regarding the goods and services to be provided. Specifications may include engineering and design standards, performance criteria, and commercial and legal terms and conditions. In conjunction with development of the specifications, PG&E establishes its vendor selection criteria, which might include such factors as cost, delivery or construction schedule, and participation in PG&E's vendor diversity program. PG&E then provides the vendors with instructions regarding the bidding process, collects and evaluates the bids, and makes a vendor selection based on the vendor selection criteria. The final step in the process is to document and enter into a written contract with the vendor, based on

PG&E's previously developed specifications and the vendor's bid proposal.[2]

B. Description of Procurement Work to be Completed by Buyers, Clerks and Consultant.

The temporary staff and consultant described below will assist PG&E with the process of obtaining New Contracts for goods and services that the New Entities will need to operate (the "Procurement Work"). While PG&E has in-house expertise in this area, PG&E requires substantial outside assistance as a result of the volume of New Contracts required and the limited time period for completion of the work. The contractors described below will perform their portion of the Procurement Work at the direction of and under the supervision of PG&E.

1. Buyers. PG&E intends to utilize approximately 20 individuals as buyers ("Buyers"). These individuals will be hired on a temporary basis through Corestaff Services, Inc. ("Corestaff"), a staffing agency. Under the direction of a PG&E supervisor, the Buyers will be responsible for coordinating and conducting negotiations for the New Contracts. This will include developing technical and commercial requirements, identifying and qualifying vendors, establishing bid evaluation criteria, soliciting proposals from vendors, negotiating contract terms and conditions, and contract documentation.

PG&E requests approval to incur approximately $3.5 million in expenses with respect to the services of the Buyers for the period beginning May 2002 and continuing to the Effective Date (as defined in the Plan), or such earlier date on which the Procurement Work has been completed. PG&E would pay the Buyers, through Corestaff, on a weekly or bi-monthly basis, based on the number of hours worked by each Buyer.

2. Clerks. PG&E also intends to utilize approximately 10 individuals as clerks ("Clerks"). These individuals will also be hired on a temporary basis through Corestaff.

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[2]PG&E does not always use a bidding process for new procurement contracts, for example, in situations where only one vendor meets the qualification criteria or PG&E has worked with a particular vendor in the past and believes that such vendor is the best choice for the particular goods or services needed.

The Clerks will support the Buyers as well as PG&E staff performing the Procurement Work and will perform general office services, such as typing, filing, copying and answering telephones.

PG&E requests approval to pay the Clerks approximately $400,000, for the period beginning May 2002 and continuing to the Effective Date (as defined in the Plan) or such earlier date on which the Procurement Work has been completed. PG&E would pay the Clerks, through Corestaff, on a weekly or bi-monthly basis, based on the number of hours worked by each Clerk.

3. Consultant. PG&E also intends to use Stan Miyamoto ("Consultant") to assist with project planning, scheduling and cost management support with respect to the Procurement Work. Consultant is experienced in providing project management support and has previously performed similar services for PG&E.

PG&E requests approval to pay Consultant approximately $80,000, for the period beginning May 2002 and continuing to the Effective Date (as defined in the Plan) or such earlier date on which the Procurement Work has been completed. PG&E would pay Consultant on a monthly basis as work is completed, based on monthly billings by Consultant.

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C. Current Need for Approval of Procurement Work.

The Procurement 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 nine months to complete the Procurement Work necessary to enable the New Entities to operate their respective businesses. The timing will vary, for example, depending on whether PG&E's existing vendors will require substantially different terms for New Contracts, or whether many of the New Contracts can replicate existing contract terms; for certain New Contracts, it may be necessary to develop new vendor relationships, which could extend the time required for completion of the New Contracts. Therefore, given the volume of work and the time that may be required for completion, PG&E believes that the process must begin now.

To the extent that subsequent events demonstrate that the Procurement Work will not be necessary, the work can be terminated immediately. PG&E's standard contractual provisions in place with Corestaff and Consultant do not guarantee future work or any minimum amount of revenue. PG&E also maintains the right to terminate the work 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. Also, any New Contracts that are negotiated prior to the Effective Date would not obligate PG&E to incur any costs or other liabilities unless and until the Effective Date occurs.

II.

THE PROCUREMENT EXPENSES SHOULD BE APPROVED PURSUANT TO SECTION 363(b)(1) OF THE BANKRUPTCY CODE

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PG&E seeks approval to pay the Buyers, Clerks and Consultant for the expenses described above ("Procurement Expenses") as a use of estate property that is outside of the ordinary course of business under Bankruptcy Code Section 363(b)(1). Although PG&E believes that the hiring of temporary staff is routine and within the ordinary course of its business, since the Procurement Work is related to implementation of the Plan, PG&E is requesting Court approval for the Procurement Expenses as outside of the ordinary course of business.

PG&E believes that the Buyers, Clerks and Consultant do not require approval as 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 Procurement Work is related to implementation of the Plan, PG&E believes that the services of the Buyers, Clerks and Consultant should not be considered "central" to the Chapter 11 case or the Plan proceedings.

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 Procurement Expenses. The Procurement Work is necessary and a delay in commencing the work could cause a delay in the implementation of the Plan. As explained above, PG&E does not have sufficient capacity in-house to handle the Procurement Work without the assistance of the Buyers, Clerks and Consultant.

Also, PG&E is solvent and has sufficient cash to pay the Procurement Expenses without causing any detriment to its creditors.[3] Thus, while there is the possibility that the Plan will not be confirmed and therefore the Procurement 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 Procurement Expenses, PG&E has attempted to strike a balance between being prepared to implement the Plan and being in a position to terminate the Procurement Work at any time.

III. CONCLUSION

For all of the foregoing reasons, PG&E respectfully requests that the Court approve the Procurement Expenses described herein, for the purposes set forth herein and grant such other and further relief as may be just and appropriate.

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DATED: April 30, 2002

Respectfully,

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

By: Julie Landau
JULIE B. LANDAU

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

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[3] 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.