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

17 In re:
18 PACIFIC GAS AND ELECTRIC
COMPANY, a California corporation,
19 Debtor.
20 Federal I.D. No. 94-0742640
21
22
23
24

Case No. 01-30923 DM
Chapter 11 Case
**OBJECTIONS TO CONFIRMATION OF
THE PG&E PLAN BY THE PEOPLE OF
THE STATE OF CALIFORNIA, EX REL.
DEPARTMENT OF TOXIC SUBSTANCES
CONTROL, ET AL.**
Date: August 1, 2002
Time: 9:30 a.m.
Place: 235 Pine St., 22nd Floor
San Francisco, California

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1 The People of the State of California, ex rel. the Department of Toxic Substances
2 Control, Central Coast Regional Water Quality Control Board, Colorado River Basin Regional
3 Water Quality Control Board, State Water Resources Control Board, Lahontan Regional Water
4 Quality Control Board, Central Valley Regional Water Quality Control Board, San Francisco
5 Bay Regional Water Quality Control Board, North Coast Regional Water Quality Control Board,
6 California Department of Fish and Game, California Department of Forestry and Fire Protection,
7 and California Department of Water Resources (the "State Entities")¹ hereby object to
8 confirmation of the Plan of Reorganization under Chapter 11 of the Bankruptcy Code for Pacific
9 Gas and Electric Company filed by Pacific Gas and Electric Company and PG&E Corp.
10 ("PG&E's Plan") proposed by Pacific Gas and Electric Company and PG&E Corp. (collectively,
11 the "PG&E Proponents").

12 INTRODUCTION

13 Pursuant to the Court's order, the State Entities file this objection to confirmation of
14 PG&E's Plan and "briefly state the grounds on which each objection is based in a manner which
15 is sufficient to give notice to the [PG&E Proponents] of the nature of the objection" The
16 State Entities reserve the right to supplement this objection with further legal and factual points
17 and authorities and to further expand these objections after discovery and in accordance with the
18 Court's briefing schedules. The State Entities reserve the right to join in any other objection to
19 confirmation of PG&E's Plan filed by any party in interest.

20 By filing these objections, the State Entities are making a special and limited appearance.
21 The State Entities do not waive any objections or defenses that the State Entities or any other
22 agency, unit, or entity of the State of California may have to this Court's jurisdiction over the

23
24 ¹ In addition, the following State agencies join only in the objections relating to the assumption
25 and/or assignment of certain executory contracts and unexpired leases under PG&E's Plan:
26 California Department of Motor Vehicles, California Energy Commission, California Department
27 of Justice, California State Board of Equalization, California Department of Parks and Recreation,
28 California Department of General Services, California Department of Consumer Affairs (Bureau
of Security and Investigative Services), and California State Lands Commission. California
Department of Transportation ("Cal Trans") also joins only in the objections relating to the
assumption and/or assignment of certain executory contracts and unexpired leases under PG&E's
Plan and is represented by the counsel listed on the signature page of this pleading. However, all
statements and reservations made in the Introduction apply to these State agencies as well.

1 State Entities or any such other agency, unit or entity based on the Eleventh Amendment or
2 related principles of sovereign immunity or otherwise, all of which are reserved. By making this
3 limited and special appearance, the State Entities do not waive the PG&E Proponents' failure to
4 give adequate, meaningful notice to any particular agency or entity of the State of California to
5 satisfy due process to the extent relief is sought in this proceeding against such agency or entity.

6 SUMMARY OBJECTIONS

7 A. The Relief Sought in PG&E's Plan Against the State Entities is Barred by 8 Sovereign Immunity.

9 1. The Eleventh Amendment to the U.S. Constitution prohibits state citizens from
10 suing the State of California or any of its departments, agencies or divisions in federal court,
11 including the Bankruptcy Court in this case. The California Public Utilities Commission (the
12 "Commission") and the State Entities represented here are units of the State of California.

13 2. PG&E's Plan seeks injunctive and declaratory relief against the Commission and
14 possibly other State Entities and agencies of the State of California.

15 3. To the extent PG&E's Plan seeks any relief against State Entities or other
16 agencies of the State of California, such relief is barred by the Eleventh Amendment to the U.S.
17 Constitution, and the State Entities (or other agencies of the State of California) assert their
18 sovereign immunity in defense thereto. Although the current version of PG&E's Plan does not
19 on its face appear to seek any monetary, declaratory or injunctive relief against any State Entities
20 other than the Commission and PG&E's Plan now provides that PG&E will follow established
21 regulatory procedures for transfer or reissuance of permits and licenses under applicable state
22 and federal law, PG&E's Plan reserves the right to seek relief in the Bankruptcy Court against
23 state agencies in the event its applications for transfer or reissuance are unsuccessful.² Thus,

24
25 ² PG&E's Plan seeks to enjoin PG&E from assuming the net open position or taking an
26 assignment of the DWR long-term electric contracts. In effect, PG&E's Plan seeks to enjoin state
27 regulatory authorities from requiring PG&E to comply with its legal obligation under its duty to
28 serve its customers. PG&E's Plan is vague as to which agencies this "reverse injunction" applies.
To the extent PG&E's Plan seeks such relief against the Department of Water Resources or any
other State agency or entity, the State Entities object to confirmation on the ground that such
relief violates sovereign immunity under the principles discussed herein and on the other bases
discussed in this pleading.

1 PG&E's Plan appears to improperly reserve to PG&E the opportunity to seek relief against state
2 regulatory agencies.

3 4. Neither the State Entities, nor any other agency or entity of the State of California,
4 has waived sovereign immunity as to any relief sought in PG&E's Plan.

5 5. The PG&E Proponents cannot meet their burden to show that any of the State
6 Entities, or any other agency or entity of the State of California, against which they seek relief
7 has knowingly and intelligently waived its sovereign immunity. In this regard, PG&E's Plan
8 does not provide adequate means for its implementation.

9 6. The State Entities intend to conduct discovery on this objection. The discovery
10 may include, but is not limited to, depositions, interrogatories, production of documents, requests
11 for admissions and third party discovery. In particular, the State Entities intend to seek
12 discovery from the PG&E Proponents as to the relief requested under PG&E's Plan against any
13 of the State Entities other than the Commission, or any other agency or entity of the State of
14 California, and the conduct that the PG&E Proponents contend evidences a waiver of sovereign
15 immunity.

16 **B. PG&E's Plan Does Not Comply With Applicable Provisions of Bankruptcy**
17 **Code (11 U.S.C. §1129(a)(1)).**

18 1. The PG&E Proponents have the burden of proving by a preponderance of the
19 evidence that "[t]he plan complies with the applicable provisions of [Title 11]." 11 U.S.C.
20 Section 1129(a)(1). PG&E's Plan must meet the requirements of §1123(a), including providing
21 adequate means for its implementation.

22 **The Bankruptcy Code Does Not Preempt State Laws or Supercede Federal**
23 **Regulatory Laws.**

24 2. PG&E's Plan contends that the Bankruptcy Code preempts certain state laws and
25 supercedes federal regulatory laws enacted to protect the public health, safety and welfare of the
26 citizens of California, as well as the State's environment.

1 3. Each of the laws that the PG&E Proponents contend is preempted or superceded
2 by the Bankruptcy Code is not purely economic in nature, but rather is directed to protecting
3 public health, safety, environment or other noneconomic concerns as follows:

4 a. California Public Utilities Code ("PUC") §377 prohibits the transfer of
5 any facility for the generation of electricity owned by a public utility prior to January 1, 2006,
6 and requires the Commission to ensure that public utility generation assets remain dedicated to
7 service for the benefit of California citizens. PUC §377 (as amended by AB6-X) is not
8 preempted by the Bankruptcy Code. PUC §377 is intended to protect the public health, safety
9 and welfare by ensuring that sufficient generation assets remain dedicated to service for the
10 benefit of all Californians. In the midst of California's energy crisis and in an effort to take
11 "immediate steps" to correct "dysfunctions in California's wholesale bulk power markets," the
12 Federal Energy Regulatory Commission ("FERC") issued its order of December 15, 2000 (the
13 "FERC Order"). 93 FERC ¶ 61,294, 61,981. The FERC Order defederalized electricity sales
14 from the retained generation assets of the public utilities (including PG&E) by eliminating the
15 Mandatory PX (Power Exchange) Buy-Sell Requirement. The California Legislature then
16 amended PUC §377 by passing AB6-X in January of 2001. PUC §377, as amended, is intended,
17 *inter alia*, to protect the public from the threat of blackouts caused by electricity shortages and to
18 implement FERC's Order. Under PG&E's Plan, the Commission is not able to "ensure that
19 [PG&E's] generation assets remain dedicated to service for the benefit of California ratepayers,"
20 as required by AB6-X.

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1 b. PG&E's Plan proposes to transfer valuable and environmentally sensitive
2 electric generation assets, including the largest privately owned hydroelectric generation system
3 in the United States,³ from one plan proponent, PG&E, to the other plan proponent, PG&E
4 Corp., through an intermediate entity to be known as Newco, without prior review and approval
5 by the Commission as required by statute. Such Commission review and approval would be
6 required even if PUC §377 did not prohibit the transfer. The State of California has enacted laws
7 to protect the public health and safety of its citizens and the environment of the state. Some of
8 these laws are implemented through the Commission's regulation of the transfer of these
9 environmentally sensitive assets. The Commission's regulation is accomplished through the
10 specific laws the PG&E Proponents contend are preempted, as set forth below. Because these
11 laws authorize the Commission to protect the public health, safety and environment, they are
12 directed at protecting the public safety or other noneconomic concerns. The PG&E Proponents
13 cannot meet their burden of showing that by enacting the Bankruptcy Code or amending
14 Section 1123(a)(5) Congress intended to impliedly preempt these laws.

15 c. By transferring these important and environmentally sensitive assets from
16 PG&E to PG&E Corp., the PG&E Proponents are permanently removing those electric
17 generation assets from Commission regulation, thus undermining the California Legislature's
18 determination that such regulation is needed to protect the public health, safety and environment.
19 Absent PUC §377, PUC §851 requires Commission approval for a proposed transfer of such

20 ³ The PG&E hydro system includes:

- 21 • 174 dams and diversions on 16 major California river and stream systems from the
22 McCloud River near Mount Shasta, to the Kern River near Bakersfield, including the Eel
23 River on the Coast Range Mountains;
- 24 • 99 reservoirs with 2.3 million acre feet of storage capacity and 200,000 acre feet of
25 consumptive water rights;
- 26 • 26 FERC licenses;
- 27 • 68 powerhouses with 3,896 MW of capacity, which provides about 5% of California's
28 electric energy;
- 140,000 acres of watershed lands, 88,000 of which are outside FERC license boundaries.

See, Draft Environmental Impact Report ("DEIR") at page ES-1 to ES-5.

1 property from a regulated utility to an unregulated entity. If the Commission approves such a
2 transfer, it is required to impose conditions on the transfer necessary to protect the public
3 interest, including health, safety and the environment.

4 d. By contending that the Bankruptcy Code preempts PUC §851, the PG&E
5 Proponents are also contending that the California Environmental Quality Act ("CEQA") is
6 preempted. The California Legislature enacted CEQA in order to protect the health, safety and
7 welfare of the citizens of California. Cal. Pub. Res. Code §21000(b)(c)(d). CEQA is a critically
8 important environmental regulatory statute which applies broadly to all "discretionary projects
9 proposed to be carried out or approved by public agencies," such as the Commission. Cal. Pub.
10 Res. Code § 21080 (a). CEQA also ensures global environmental review of successive
11 "piecemeal" disaggregations that might otherwise be too small to cause concern. When applying
12 CEQA, the Commission may not approve a project that has significant environmental impacts
13 unless all feasible mitigation measures within the jurisdiction of the Commission have been
14 imposed. Cal. Pub. Res. Code § 21081. To assure compliance with mitigation measures, CEQA
15 requires public agencies to adopt reporting and monitoring programs and to assure that
16 mitigation measures are enforceable. Cal. Pub. Res. Code § 21081(b). CEQA protects
17 California's public health, safety and welfare, which are manifestly noneconomic concerns.

18 e. For the last 80 years, the Commission has created financial incentives for
19 PG&E to operate its hydropower system, and manage its lands at stewardship levels higher than
20 minimum legal standards. These higher stewardship levels have created environmental quality
21 benefits for public trust resources. Ensuring the continued higher environmental stewardship
22 levels is part of the review process mandated by PUC §851 and enforced by the Commission. If
23 PUC §851 is preempted, the Commission would be enjoined from protecting the public health,
24 safety and welfare when these public trust resources are transferred post-confirmation.

25 f. PG&E has previously sought to divest its hydroelectric system assets. In
26 1999, PG&E applied to the Commission for permission to transfer its hydroelectric assets to
27 unregulated entities in Application No. 99-09-53. There, a Draft Environmental Impact Report
28 ("DEIR") was prepared for the Commission pursuant to its CEQA authority. While PG&E

1 asserted that its proposal would have no "significant adverse effects" on the environment, the
2 DEIR found that transferring the assets to non-regulated entities would result in forty-nine (49)
3 significant adverse effects, including impacts to water quality, air quality, endangered species,
4 forests, recreation, public safety and electrical supply reliability.⁴ According to the DEIR,
5 mitigation conditions that could be imposed by the Commission would reduce forty-seven (47)
6 of the impacts to insignificant levels, but two significant impacts could not be mitigated. See
7 DEIR, Table S-1 "Summary of Project Impacts and Mitigation by Resource."

8 g. Since PG&E has never filed an application to divest many of the assets it
9 seeks to transfer as part of its plan, the Commission has never studied the entire environmental
10 impact that such divestitures would have on the State's environment. CEQA review, pursuant to
11 PUC §851, is also required for divestiture of these other assets and it is possible that those
12 transfers would also have significant adverse environmental impacts.

13 h. Transferring the electric generation assets from the regulated utility to an
14 unregulated entity will eliminate the Commission's ability to prospectively assure, through
15 CEQA review, that future modifications and additions to those transferred assets will not have
16 significant adverse impacts on the environment.

17 i. Public control over the transfer of these assets provides the State of
18 California, through Commission regulation, the inherent ability to ensure that the assets are
19 operated in a manner that protects and preserves the environment. The California Legislature
20 uses its legal authority to regulate utilities to, *inter alia*, protect the environment.

21 4. The laws the PG&E Proponents contend are preempted are of broad and general
22 applicability, unquestionably apply to PG&E, and were promulgated long before PG&E filed its
23 chapter 11 bankruptcy case. The specific laws the PG&E Proponents contend are preempted do
24 not stand as an obstacle to the accomplishment and execution of the purposes and objectives of
25

26 ⁴ The entire DEIR is available at <http://Commission-pgehydro.support.net>. Due to the
27 voluminous nature of the DEIR (4,000 pages, nine volumes), the State Entities are not providing
28 the Court with a copy at this time; however, the State Entities do request that the Court review the
Executive Summary to the DEIR and admit the DEIR as evidence in this proceeding. Fed. R.
Evid. 803(8).

1 Congress and the Bankruptcy Code. The laws the PG&E Proponents contend are preempted do
2 not directly conflict with the purposes of the Bankruptcy Code in any way that could be
3 generalized beyond the particular aspects of PG&E's Plan. Thus, PG&E's Plan does not provide
4 adequate means for its implementation. The PG&E Proponents misstate their burden on this
5 element of preemption in the disclosure statement to PG&E's Plan.

6 5. The State Entities intend to conduct discovery on this objection. The discovery
7 may include, but is not limited to, depositions, interrogatories, production of documents, requests
8 for admissions and third party discovery. In particular, the State Entities intend to seek
9 discovery respecting: (a) the PG&E Proponents' commitment to maintaining existing
10 environmental standards; and (b) the factual basis for the PG&E Proponents' contention that the
11 laws their plan seeks to preempt are directed only towards economic purposes and stand as an
12 obstacle to the accomplishment and execution of the purposes and objectives of Congress and the
13 Bankruptcy Code.

14 **PG&E's Plan Improperly Grants a Non-Debtor Release.**

15 6. PG&E's Plan releases PG&E Corp. from any and all claims arising under the
16 "First Priority Rule" and any claims arising under Section 17200 of the California Business and
17 Professions Code. The proposed release improperly includes claims belonging to others,
18 including the California Attorney General and the City and County of San Francisco, on the
19 erroneous basis that such claims are property of the estate. See, Memorandum Decision on
20 Motions to Remand issued June 14, 2002, page 20-21. The release violates the Bankruptcy Code
21 and a plan containing such a release cannot be confirmed.

22 7. The State Entities intend to conduct discovery on this objection. The discovery
23 may include, but is not limited to, depositions, interrogatories, production of documents, requests
24 for admissions and third party discovery. In particular, the State Entities intend to seek
25 discovery regarding the PG&E Proponents' factual and legal basis for seeking a release of a non-
26 debtor contrary to established law. The State Entities also intend to conduct discovery regarding
27 the value of the claims being released by PG&E's Plan.
28

1 **PG&E's Plan Does Not Comply With the Requirements for the Assumption &**
2 **Assignment of Executory Contracts and Unexpired Leases.**

3 8. PG&E's Plan assumes and/or assigns all executory contracts and unexpired leases
4 to which any agency or entity of the State of California is a party, unless PG&E files a motion to
5 reject such contract or lease, or PG&E amends its lists of assumed and assigned contracts and
6 leases in the Plan Supplement.

7 9. Cal Trans and the State Entities⁵ object to the assumption and assignment of any
8 such executory contract or unexpired lease unless the requirements of 11 U.S.C. §365 are met,
9 including but not limited to, subsections (b)(1), (c), (d)(2), (d)(3), (e), and (f). More specifically,
10 and without limiting the foregoing in any respect, the State Entities object to the assumption
11 and/or assignment of any executory contract or unexpired lease to the extent that:

12 a. Certain items listed under PG&E's Plan as a "contract" or "lease" are not
13 contracts or leases at all, but rather are permits, licenses, regulatory requirements, or statutory
14 obligations of PG&E or an entity to be created under PG&E's Plan.

15 b. In the event the lease between a state agency and PG&E is a sublease
16 where the state agency is the landlord to PG&E, there may be use restrictions in the master lease
17 between the state agency and the land owner that limit the use of the premises by PG&E or its
18 assignee. Cal Trans and the State Entities object to the assignment of any such lease to any
19 entity to the extent the assignee does not comply with such use restrictions, thereby causing Cal
20 Trans or the State Entities to be in default under the terms of the master lease. Any assumption
21 and/or assignment must be of the entire lease with all of its terms, including use restrictions.

22 11 U.S.C. §365.

23
24 ⁵ As stated in footnote 1 herein, the following State agencies join only in the objections relating to
25 the assumption and/or assignment of certain executory contracts and unexpired leases under
26 PG&E's Plan: California Department of Motor Vehicles, California Energy Commission,
27 California Department of Justice, California State Board of Equalization, California Department
28 of Parks and Recreation, California Department of General Services, California Department of
Consumer Affairs (Bureau of Security and Investigative Services), and California State Lands
Commission. In addition, Cal Trans, which is separately represented by the counsel listed, joins
only in the objections relating to the assumption and/or assignment of certain executory contracts
and unexpired leases under PG&E's Plan.

1 c. PG&E is attempting to assume and/or assign part but not all of a contract
2 or lease according to its terms in violation of Section 365.

3 d. Cal Trans or the State Entities cannot identify any contract or lease that
4 corresponds to PG&E's list in its Plan Supplement.

5 10. Cal Trans and the State Entities intend to conduct discovery on this objection.
6 The discovery may include, but is not limited to, depositions, interrogatories, production of
7 documents, requests for admissions and third party discovery. In particular, Cal Trans and the
8 State Entities intend to seek discovery on the PG&E Proponents' factual and legal basis for
9 assuming and assigning any instrument that is not actually a "contract" or "lease," for any
10 assumption and assignment of a lease that would result in a violation of a use restriction, or for
11 the assumption and assignment of less than the entire contract or lease. Further, Cal Trans and
12 the State Entities will conduct discovery on what PG&E intends to offer as proof that the
13 requirements of section 365 are met with regard to each contract or lease to which any agency or
14 entity of the State of California is a party.

15 **C. PG&E's Plan Is Not Proposed in Good Faith and Is Proposed by Means**
16 **Forbidden by Laws (11 U.S.C. §1129(a)(3)).**

17 1. PG&E's Plan is not proposed in good faith because PG&E Corp. is manipulating
18 its control over PG&E in the bankruptcy proceedings to subordinate the interests of PG&E and
19 its ratepayers to PG&E Corp., as part of a common plan or design to evade the Commission's
20 jurisdiction and to promote the corporate objectives of PG&E Corp. for its own gain and the gain
21 of its subsidiaries and affiliates to the detriment of ratepayers. PG&E's Plan effectively
22 supplants the California Legislature by revising the existing utility regulatory structure as it
23 applies to PG&E and deprives ratepayers of the benefits and protections which are to be afforded
24 them through the Commission's existing authority over PG&E. PG&E's Plan is further designed
25 to create a safe haven for PG&E Corp. and its officers and directors by attempting to protect
26 them against liability for their improper prepetition conduct, including but not limited to causing
27 PG&E to transfer over \$4 billion in ratepayer-generated funds to PG&E Corp. PG&E's Plan
28 improperly seeks approval to:

- 1 a. restructure PG&E's operations, including transferring PG&E's electric
2 transmission, gas transmission and generation lines of business to newly created limited liability
3 companies under the control of PG&E Corp. or its affiliates at below market prices, in violation
4 of law, and without approval from the Commission. While PUC §377 prohibits such transfers,
5 PUC §851 requires every public utility to secure authorization from the Commission prior to
6 disposing of any property "necessary or useful in the performance of its duties to the public."
7 The Commission's authority under PUC §851 is fundamental to utility regulation because it
8 ensures that the Commission maintains the powers and functions necessary to protect the public;
- 9 b. transfer PG&E's generating assets in violation of the Legislature's
10 mandate in AB6-X (PUC §377), and at below fair market value without Commission approval or
11 any revenue sharing agreement or other means of sharing any gain with ratepayers;
- 12 c. prohibit the Commission and the State of California from taking any
13 action related to the allocation or other treatment of any "gain on sale" related to assets
14 transferred or disposed of under PG&E's Plan that would adversely impact PG&E or its
15 ratepayers;
- 16 d. change the ownership structure for PG&E without Commission approval,
17 precluding the Commission from imposing any conditions necessary to protect the public and
18 maintain ratepayer indifference;
- 19 e. evade compliance with the Affiliate Transaction Rules established by the
20 Commission in the public interest, in part, to ensure that ratepayers are not subsidizing
21 unregulated activities. The Affiliate Transaction Rules are applicable to the restructuring
22 transactions between PG&E and PG&E Corp. and its affiliates which are proposed in PG&E's
23 Plan. These rules also require allocating the gain on sale of public utility property to or between
24 shareholders and ratepayers;
- 25 f. evade compliance with the 22 Holding Company Conditions which the
26 Commission imposed upon PG&E and PG&E Corp. in approving the holding company
27 formation, and the agreement by the board of directors for PG&E and PG&E Corp. to abide by
28

- 1 these conditions. The Commission determined that these conditions were necessary to protect
2 the public's interest and maintain ratepayer indifference;
- 3 g. shift the Commission's regulatory authority over certain PG&E
4 operations and activities from the Commission to FERC in a manner that would result in
5 regulation of PG&E's operation in a manner different than other similarly situated California
6 utilities engaged in similar operations and activities;
- 7 h. deregulate certain operations and activities currently conducted by PG&E
8 from the Commission's jurisdiction; and
- 9 i. release non-debtors, PG&E Corp. and its officers and directors, from any
10 claims for fraudulent conveyances/transfers under the Bankruptcy Code or any other analogous
11 state statutes, including California Business and Professions Code Section 17200.
- 12 2. These goals of PG&E's Plan are not consistent with the objectives and purposes
13 of the Bankruptcy Code of successful rehabilitation and payment of creditors. Because PG&E's
14 Plan effectively seeks to restructure the existing utility structure in California as it applies to
15 PG&E, to subordinate the interests of PG&E and its ratepayers to the interests of PG&E Corp.
16 and its other subsidiaries and affiliates, and to evade the Commission's regulatory authority as
17 part of a common plan or design to benefit and gain non-debtors, PG&E's Plan is not proposed
18 in good faith.
- 19 3. PG&E's Plan is proposed by a means forbidden by law in that it proposes
20 transactions that violate California law, improperly relies upon preemption of non-economic
21 state laws, improperly relies on a finding that the Bankruptcy Code overrides other federal laws,
22 and seeks relief that is not available because of the State's sovereign immunity.
- 23 4. As written, PG&E's Plan violates numerous state and federal laws, including but
24 not limited to all the laws the PG&E Proponents contend are preempted, PUC §§377 and 851,
25 and PG&E Corp.'s "first priority obligation."
- 26 5. PG&E's Plan violates numerous federal laws that either grant exclusive
27 jurisdiction to the State or require compliance with State law. Under the "coexistence" doctrine
28 of statutory construction, the Court must give effect to the Bankruptcy Code and federal

1 nonbankruptcy law if possible. There are several provisions of the Federal Power Act ("FPA"),
2 the Natural Gas Act ("NGA"), and the Public Utility Holding Company Act ("PUHCA") that
3 mandate compliance with state law or require state regulatory approval for actions contemplated
4 by PG&E's Plan. The PG&E Proponents contend, and confirmation of PG&E's Plan depends on
5 a finding, that the Bankruptcy Code overrides these federal nonbankruptcy laws. Since each of
6 these federal nonbankruptcy laws can coexist with the Bankruptcy Code such that the
7 Bankruptcy Code does not override them, PG&E's Plan also does not provide adequate means
8 for its implementation. PG&E's Plan violates federal law in each of the areas discussed below:

9 a. Sections 19 and 20 of the FPA provide that licenses for hydroelectric
10 projects are to be subject to the rate and securities regulation of the states. See 16 U.S.C. §§812-
11 13. Only in instances where a state does not regulate is it permissible under the FPA for FERC
12 to assume jurisdiction over rate and securities regulation. PG&E's Plan to disaggregate and
13 deregulate, however, calls for FERC jurisdiction in place of state regulation in this area, which
14 directly contradicts the provisions of Sections 19 and 20 of the FPA. The Bankruptcy Code and
15 these provisions of the FPA are capable of coexistence, such that PG&E's Plan violates the FPA.

16 b. Section 204 of the FPA, 16 U.S.C. §824c, requires public utilities such as
17 PG&E to obtain authorization for the issuance of securities from FERC. Subpart (f) of this
18 section, however, provides that "The provisions of this section shall not extend to a public utility
19 organized and operating in a State under the laws of which its security issues are regulated by a
20 State commission." See 16 U.S.C. §824c(f). As PG&E admits, PUC §§816-830 require the
21 Commission's approval for the issuance of debt or equity securities. Thus, federal law requires
22 the application of state law. In this regard, PG&E's Plan not only seeks preemption of state law,
23 but also authority to violate applicable nonbankruptcy federal law. In the FERC proceedings,
24 PG&E contends that the Bankruptcy Code prevails over the FPA such that the Bankruptcy Court
25 approval and FERC approval of the issuance of securities is all that is required. The Bankruptcy
26 Code and these provisions of the FPA are capable of coexistence, such that PG&E's Plan
27 violates the FPA.
28

1 c. Section 1(c) of the NGA, 15 U.S.C. §717(c), specifically provides that
2 certain natural gas pipelines are regulated by the states and not FERC. These pipelines are
3 known generically as "Hinshaw" pipelines. A Hinshaw pipeline under Section 1(c) is any
4 pipeline that is used to transport gas from the border of a state or from within the boundaries of a
5 state to a point of consumption within that state so long as the pipeline is regulated by the state.
6 Currently, all of PG&E's natural gas pipeline systems in California are intrastate, and thus are
7 Hinshaw pipelines. PG&E's Plan relies on FERC approval to add a three-mile segment to its
8 pipeline system that would cross the Oregon border. PG&E argues that if FERC approves this
9 addition then PG&E would be operating an interstate pipeline system that would be regulated by
10 FERC instead of the Commission. However, FERC does not have jurisdiction over PG&E's
11 application to add the three-mile segment or to authorize abandonment and transfer of intrastate
12 pipelines, because PG&E's pipelines are Hinshaw pipelines, exempt from FERC regulation.
13 Only if the appropriate state regulator, here the Commission, approves the addition and the
14 abandonment and transfer will PG&E's pipeline system be an interstate pipeline subject to FERC
15 regulation. Again, PG&E's Plan violates applicable nonbankruptcy federal law. The
16 Bankruptcy Code does not prevail over the NGA.

17 d. PG&E has applied for and must obtain approval of the Securities and
18 Exchange Commission ("SEC") under Public Utility Holding Company Act ("PUHCA") for its
19 disaggregation and deregulation plan. However, section 10(f) of PUHCA provides that the SEC
20 cannot approve any acquisition "unless it appears to the satisfaction of the [SEC] that such State
21 laws as may apply in respect of such acquisition have been complied with." See 15 U.S.C.
22 §79(j). In the SEC proceedings, PG&E argues that the SEC can approve the application
23 notwithstanding section 10(f) because the Bankruptcy Code preempts state law, but also admits
24 that this is a conflict of laws issue. The Bankruptcy Code does not preempt state law in a manner
25 that nullifies section 10(f), nor does it prevail over PUHCA.

26 e. PG&E's Plan also violates Section 32 of PUHCA regarding exempt
27 wholesale generator status. In 1992, Congress added an exemption for certain types of
28 generators known as "exempt wholesale generators." Under this provision, FERC is to make

1 determinations regarding whether facilities qualify for exempt wholesale generator status. For
2 existing rate-based facilities such as PG&E's, Section 32(c) specifically requires the state to
3 consent to the exemption. 15 U.S.C. §79z-5a. While PG&E is not requesting exempt wholesale
4 generator status to implement its plan, PG&E's FERC and SEC applications are crafted to permit
5 PG&E to receive the benefits of the exemption without obtaining the approval of state regulatory
6 authorities, contrary to Section 32(c) and the intent of Congress. PG&E will have to take the
7 position, which is contrary to case law, that the Bankruptcy Code allows the transactions to occur
8 nullifying the effect of Section 32(c).⁶ The Bankruptcy Code does not override the operation of
9 Section 32(c) of PUHCA.

10 6. PG&E's Plan does not assure that the higher state safety requirements set forth in
11 the California Nuclear Facility Decommissioning Act of 1985 (PUC §§8321 through 8930) can
12 be met. That Act was passed "to protect California's citizens from exposure to radiation from
13 nuclear facilities." Nor does PG&E's Plan ensure that the ultimate costs and health and safety
14 impacts of the decontamination and decommissioning of the Diablo Canyon Power Plant are
15 reduced to the lowest levels possible, given California's stricter standards, or that a Diablo
16 Canyon LLC will have sufficient capitalization required to meet higher California requirements.
17 Moreover, PG&E's Plan does not address the continuation of the Diablo Canyon Independent
18 Safety Committee, which was formed as part of a settlement agreement arising out of the
19 Commission's oversight over the Diablo Canyon Power Plant, and which has an independent
20 safety role under California regulation. In this regard, PG&E's Plan also lacks adequate means
21 for its implementation.

22 7. The State Entities intend to conduct discovery on this objection. The discovery
23 may include, but is not limited to, depositions, interrogatories, production of documents, requests
24 for admissions and third party discovery. In particular, the State Entities intend to seek
25 discovery on the PG&E Proponents' factual and legal basis for any contention that the
26 Bankruptcy Code and other federal laws cannot coexist, regarding compliance with the

27 ⁶ PG&E's disaggregation and deregulation plan may also depend on the Bankruptcy Code
28 nullifying provisions of the Raker Act, 38 Stat. 242 (1913), which is subject to the same conflict
of laws test.

1 California Nuclear Facility Decommissioning Act of 1985, and regarding the PG&E Proponents'
2 scheme to transfer valuable assets to the Debtor's parent under the guise of a plan of
3 reorganization for little consideration and benefit to the Debtor. Discovery will also be requested
4 from individual directors and subsidiaries and affiliates of the PG&E Proponents and other third
5 parties.

6 **D. PG&E's Plan Is Not Feasible (11 U.S.C. §1129(a)(11)).**

7 1. The Plan Proponents are required to prove that confirmation of PG&E's Plan is
8 not likely to be followed by liquidation or the need for further financial reorganization. 11
9 U.S.C. § 1129(a)(11). The PG&E Proponents must show that the plan has a reasonable
10 probability of success and is workable.

11 2. PG&E's Plan is not feasible because it does not have a reasonable probability of
12 success and is not workable for many of the reasons already stated. PG&E's Plan improperly
13 relies upon preemption by the Bankruptcy Code of non-economic laws where no such
14 preemption exists. The PG&E Plan improperly relies on the Bankruptcy Code overriding other
15 federal nonbankruptcy law such as the FPA, the NGA, and the PUHCA.

16 3. In addition, PG&E's Plan depends upon the timely approvals by FERC and other
17 federal regulatory agencies of numerous transactions that will not be timely obtained, if obtained
18 at all.

19 4. Further, the implementation of PG&E's Plan depends on relief that is not
20 available under the Bankruptcy Code because of sovereign immunity and PG&E's Plan
21 improperly relies on the alleged waiver of sovereign immunity.

22 5. The State Entities intend to conduct discovery on this objection. The discovery
23 may include, but is not limited to, depositions, interrogatories, production of documents, requests
24 for admissions and third party discovery. In particular, the State Entities intend to seek
25 discovery on the PG&E Proponents' factual and legal basis for contending that PG&E's Plan is
26 feasible given the many legal problems it faces.

1 **E. PG&E's Plan Is Not in the Public Interest.**

2 1. The interest of the public must be considered at confirmation of the plan of
3 reorganization of a public utility. See e.g., American United Mut. Life Ins. Co. v. City of Avon,
4 311 U.S. 138, 145, 61 S.Ct. 157, 161-62, 85 L.Ed.2d 91 (1940); N.L.R.B. v. Bildisco and
5 Bildisco, 465 U.S. 513, 104 S. Ct. 1188, 104 S. Ct. 1188 (1984); In re Public Service Company
6 of New Hampshire, 108 B.R. 854, 873-74 (Bankr. D.N.H. 1989).

7 2. PG&E's Plan is not in the public interest as it goes well beyond adjusting
8 debtor/creditor relations, impacting many others who are without a voice in this Court of limited
9 jurisdiction. PG&E's Plan manipulates the bankruptcy system to adjust the regulatory
10 framework applicable to public utilities in California and seeks to evade State regulation deemed
11 important by the California State Legislature for the protection of the public. Such attempts to
12 use the Bankruptcy Code to evade State law are inconsistent with Congressional intent evinced
13 in 28 U.S.C. §959(b) and elsewhere (i.e., criminal enforcement and regulatory exceptions to the
14 automatic stay, 11 U.S.C. §362(b)(1) and (4)). Further, the impacts of PG&E's Plan go beyond
15 the creditors in the proceeding and profoundly affect non-creditors, such as ratepayers, as well as
16 the environment. However, because of their non-creditor status, those most impacted by
17 PG&E's Plan are unable to participate in this proceeding to express their concerns with PG&E's
18 attempt to evade State regulatory laws and with its attempt through the Bankruptcy Court to
19 transfer generation assets in contravention of State law. If PG&E wants a change in the
20 regulatory framework, PG&E should seek it through the legislative process or other appropriate
21 means where all affected and concerned have a voice. PG&E's unilateral attempt to effectuate
22 "self-deregulation" and transfer of generation assets in contravention of State law in this
23 bankruptcy proceeding is not in the public interest.

24 3. As PG&E has noted in its pleadings before this Court, PG&E serves in excess of
25 4,500,000 electric power and gas customers in Northern California. The State Legislature has
26 determined that retention of investor owned utility generation assets in a manner that ensures
27 they are dedicated to serve California citizens is necessary to protect the public interest. PUC
28 §377. PG&E's Plan seeks to transfer these assets in a manner that prohibits the Commission

1 from ensuring that they remain dedicated to serving the public needs as mandated by the
2 California Legislature.

3 4. As part of its hydroelectric system, PG&E holds over 140,000 acres of
4 environmentally sensitive lands, over 170 dams and diversions on 16 major California rivers and
5 streams, and over 95 reservoirs. PG&E also holds other environmentally sensitive lands.
6 Currently, state law operates to maximize protection of these lands and waters through, *inter*
7 *alia*, the regulatory oversight of the Commission. PG&E's Plan *bypasses this regulatory*
8 *oversight and significantly alters the economic incentives favoring proper environmental*
9 *stewardship, all to the harm of the present and future citizens of the State of California.*

10 5. It is no answer to claim, as the PG&E Proponents argue in their disclosure
11 statement, that there will be no regulatory gap since federal agencies will regulate the new
12 entities and the post-confirmation entities will comply with all applicable state and federal laws.
13 The federal agencies do not have the same charter to protect the health, safety and environment
14 of the State of California as the Commission does under California law. The very existence of
15 such laws shows that the California Legislature has determined that federal regulation is not
16 sufficient to protect localized interests in health, safety and the environment. In this regard,
17 PG&E's Plan lacks adequate means for its implementation.

18 6. The State Entities intend to conduct discovery on this objection. The discovery
19 may include, but is not limited to, depositions, interrogatories, production of documents, requests
20 for admissions and third party discovery. In particular, the State Entities intend to seek
21 discovery on the PG&E Proponents' factual and legal basis for contending that PG&E's Plan is
22 in the public interest.

23 **F. The Commission's Plan is Preferable under 11 U.S.C. §1129(c).**

24 1. If both PG&E's Plan and the Commission's Plan meet the requirements of section
25 1129(a) and/or (b), the Commission's Plan is preferable under 11 U.S.C. §1129(c). Pursuant to
26 section 1129(c), the Court must consider, but does not have to follow, the preferences of
27 creditors and equity security holders in determining which plan to confirm. The Court should
28 also consider other factors including the type of plan (reorganization or liquidation), feasibility,

1 the treatment of creditors and equity holders, societal needs, whether a plan benefits insiders at
2 the expense of creditors, whether delay and further litigation are likely to follow confirmation,
3 and whether the plan is a "sweetheart" plan favoring one party.

4 2. For the same reasons that PG&E's Plan is not in the public interest, not feasible,
5 and not confirmable, it is also not the preferable plan. PG&E's Plan may well result in
6 significant adverse environmental impacts. It will certainly preclude the Commission's
7 comprehensive public interest review of the plan's system-wide disaggregation. And it will
8 impair the Commission's regulatory authority over the public health, safety and welfare and the
9 environment. PG&E's Plan is a "sweetheart plan" benefiting the debtor's insider parent at the
10 expense of the citizens of the State of California. Moreover, confirmation of PG&E's Plan is
11 likely to result in delay and further litigation due to appeals by the State Entities and the
12 Commission. The State Entities have a duty to vigorously defend the laws of the State of
13 California against PG&E's attacks. The State Entities cannot agree to any plan of reorganization
14 that is illegal under California law, especially in light of the clear Congressional intent that a
15 debtor must reorganize within the boundaries of state and federal law. 28 U.S.C. §959(b).

16 3. The State Entities intend to conduct discovery on this objection. The discovery
17 may include, but is not limited to, depositions, interrogatories, production of documents, requests
18 for admissions and third party discovery. In particular, the State Entities intend to seek
19 discovery on the PG&E Proponents' factual and legal basis for contending that PG&E's Plan is
20 the preferable plan under section 1129(c).

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1 CONCLUSION

2 The State Entities object to confirmation of PG&E's Plan on the foregoing grounds. The
3 State Entities reserve the right to further brief the Court on the legal and factual bases for these
4 objections, and any other objections, to the extent discovery reveals other bases to object to
5 PG&E's Plan.

6 Dated: July 17, 2002

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