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7 PACIFIC GAS AND ELECTRIC COMPANY

8 UNITED STATES BANKRUPTCY COURT
9 NORTHERN DISTRICT OF CALIFORNIA
10 SAN FRANCISCO DIVISION

11 In re
12 PACIFIC GAS AND ELECTRIC
13 COMPANY, a California corporation,
14 Debtor.
15 Federal I.D. No. 94-0742640

Case No. 01 30923 DM
Chapter 11 Case
Date: November 5, 2002
Time: 9:30 a.m.
Place: 235 Pine Street, 22nd Floor
San Francisco, California

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18 MEMORANDUM OF POINTS AND AUTHORITIES IN SUPPORT OF DEBTOR'S
19 MOTION FOR ORDER APPROVING ENTRY INTO RESCISSION AGREEMENT AND
MUTUAL RELEASE BETWEEN DEBTOR AND RCN TELECOM SERVICES

20 [Notice of Motion and Declaration of Lori I. Austin in Support Filed Concurrently Herewith]
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I.

INTRODUCTION

1 Pacific Gas and Electric Company ("PG&E" or "Debtor"), the debtor and debtor in
2 possession in the above-captioned Chapter 11 case, seeks the Court's approval of the
3 Debtor's entry into an agreement with telecommunications company RCN Telecom Services
4 ("RCN"), which rescinds a lease agreement with RCN and resolves potential disputes
5 between the parties. On November 20, 2000, PG&E and RCN entered into a "Master
6 Conduit and Facilities License and Lease Agreement" ("Master Agreement"). Under the
7 Master Agreement, PG&E agreed to lease certain deactivated PG&E gas pipelines in San
8 Francisco to RCN to run fiber optic and coaxial cables and associated equipment. The
9 Master Agreement required RCN to make a series of graduated payments reflecting the
10 number of miles of gas pipeline utilized by RCN up to a total of 100 miles over the life of
11 the 99-year lease. Under the Master Agreement, RCN reserved 30 miles of gas pipeline and
12 paid PG&E \$876,170.72 in January 2001. RCN did not install any telecommunications
13 equipment in the reserved lines. Subsequently, RCN told PG&E that its financial condition
14 was such that it was unable to pay the next installment of \$248,384.50 due on January 1,
15 2002 or make any payments thereafter. RCN failed to make the January payment. On
16 March 21, 2002, PG&E notified RCN that it was in default under the Master Agreement and
17 gave notice of termination. Under the Master Agreement, upon termination PG&E would be
18 required to refund approximately \$832,000 of the \$876,170.72 (19/20 or 95%) RCN had
19 paid PG&E.
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22 PG&E's underground gas pipelines are in San Francisco streets pursuant, in part,
23 to a gas franchise agreement with the City and County of San Francisco ("CCSF"). CCSF
24 has challenged PG&E's rights to lease its former gas pipelines to RCN, alleging that the
25 Master Agreement breached the franchise agreement and violated the local ordinance
26 incorporating the franchise agreement into CCSF's municipal code.
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1 In view of RCN's default and CCSF's claims, PG&E seeks the Court's
2 authorization to compromise the dispute with RCN by rescinding the Master Agreement on
3 terms beneficial to both parties on the basis that such a result would best promote the
4 business interests of PG&E's estate.

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6 II.

7 **FACTS AND PROCEDURAL HISTORY¹**

8 PG&E has the right to run underground gas pipelines in San Francisco pursuant,
9 in part, to a franchise agreement with the City and County of San Francisco ("CCSF"),
10 which is codified in CCSF Municipal Code (the "CCSF Gas Franchise"). On November 20,
11 2000, PG&E entered into the Master Agreement with RCN. The Master Agreement was
12 designed to provide RCN with the right to install and maintain telecommunications cables
13 such as fiber optic cable and associated equipment in certain deactivated PG&E gas
14 pipelines in San Francisco for a period of up to 99 years. *Id.* at ¶ 1.1.

15 Under the Master Agreement, RCN was to reserve a minimum amount of gas line
16 each year and make an up-front payment for each section of gas line reserved. In addition,
17 RCN was required to make annual payments for each section of deactivated gas line
18 reserved. The amounts payable by RCN were calculated using a formula set forth in the
19 Master Agreement, which was based (in part) on how much of pipeline RCN reserved.
20 Master Agreement ¶8.1. The first amount due under the Master Agreement represented a
21 20-year payment for 30 miles of pipeline. For each of the next 9 years of the Master
22 Agreement, RCN would pay an amount representing a 20-year payment for 8 miles of
23 pipeline, until RCN reached the maximum of 100 miles of pipeline for which RCN had
24 contracted. After the first 20 years of the Master Agreement had elapsed, RCN was required
25 to pay an amount every 10 years representing 10 years of use of 100 miles of pipeline. Thus,

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27 ¹The evidentiary basis and support for the facts set forth herein are contained in the
28 Declaration of Lori I. Austin In Support of Debtor's Motion For Order Approving
Rescission Agreement And Mutual Release Between Debtor And RCN Telecom Services
filed concurrently herewith.

1 it was anticipated that RCN's use of pipeline would increase over the term of the Master
2 Agreement. If the Master Agreement were terminated by either party before the end of the
3 term, the parties agreed that PG&E would refund RCN the prorata portion of the payments
4 received that were allocable to future use. Master Agreement ¶ 8.1(d).

5 On January 1, 2001, RCN made its first payment of \$876,553.92 under the
6 Master Agreement. A further \$248,384.50 was due under the Master Agreement on
7 January 1, 2002. In November 2001, RCN told PG&E that its financial situation had
8 deteriorated, and it would not be making the January 2002 payment or any other payments.
9 Moreover, RCN told PG&E that its pipeline capacity needs had decreased substantially, and
10 the Master Agreement provided for pipeline capacity far in excess of RCN's anticipated
11 needs. RCN did not make the January payment and has made no subsequent payments. In
12 March 2002, PG&E notified RCN that it proposed to terminate the Master Agreement due to
13 RCN's default.

14 After the Master Agreement was executed, CCSF claimed that the Master
15 Agreement was in violation of the CCSF Gas Franchise.² PG&E's San Francisco pipeline
16 use was limited, CCSF claimed, to gas-related uses, not telecom-related uses.

17 In view of RCN's failure to make the January payment, statements regarding its
18 financial position and lack of need for the pipeline capacity for which it had contracted, the
19 Master Agreement provision requiring PG&E to return to RCN on termination
20 approximately 19/20 (or 95%) of the \$876,533.92, and CCSF's allegations that PG&E was
21 not authorized to enter into the Master Agreement, PG&E concluded that maintaining the
22 Master Agreement was not in PG&E's business interests. Accordingly, PG&E negotiated an
23 agreement with RCN to rescind the Master Agreement to resolve any dispute with RCN and
24 also avoid any potential dispute with CCSF (the "Rescission Agreement"). The Rescission
25 Agreement provides for PG&E to refund \$873,170.72 (the amount RCN paid PG&E
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27 ²CCSF has filed a claim in PG&E's bankruptcy action (Claim No. 12640), which
28 included a claim for an "unknown" amount relating to PG&E's proposed lease of its
abandoned gas lines to RCN.

1 pursuant to ¶8.1 of the Master Agreement, less certain costs incurred by PG&E under the
2 Master Agreement), without any requirement that PG&E pay interest to RCN. Furthermore,
3 the Rescission Agreement provides for mutual releases of liability and makes explicit that
4 the entry into the Rescission Agreement is not a rejection of the Master Agreement for
5 Bankruptcy purposes; and, therefore, PG&E is not liable to pay rejection damages.
6 Rescission Agreement ¶¶4-5. The Rescission Agreement provides a reasonable resolution of
7 the issues and potential disputes that arose out of the Master Agreement in a manner that is
8 beneficial to PG&E and fair to RCN.

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10 **III.**
11 **ARGUMENT**

12 **A. The Rescission Agreement Compromises The Potential Dispute With RCN**
13 **Under Terms Fair To Both Parties Without The Expense And Diversion Of**
14 **Resources Involved In Litigation And Should Be Authorized Pursuant To**
15 **Bankruptcy Rule 9019.**

16 Bankruptcy law favors compromises, which are considered “a normal part of the
17 process of reorganization.” Protective Comm. for Indep. Stockholders of TMT Trailer Ferry
18 Inc. v. Anderson, 390 U.S. 414, 424 (1968). Accordingly, the Bankruptcy Court has great
19 latitude in approving compromise agreements. See Martin v. Kane (In re A & C Props.),
20 784 F.2d 1377, 1380-81 (9th Cir. 1986). The Court’s discretion is not, however, unlimited.
21 See Arden v. Motel Partners (In re Arden), 176 F.3d 1226, 1228 (9th Cir. 1999). The Court
22 may approve a compromise only if it is “fair and equitable.” Protective Comm. for Indep.
23 Stockholders of TMT Trailer Ferry Inc., 390 U.S. at 424. In evaluating any proposed
24 compromise, the Court must consider the following factors:
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1 (a) The probability of success in the litigation; (b) the difficulties, if
2 any, to be encountered in the matter of collection; (c) the complexity
3 of the litigation involved, and the expense, inconvenience and delay
4 necessarily attending it; (d) the paramount interest of the creditors and
a proper deference to their reasonable views in the premises.
(Woodson v. Fireman's Fund Ins. Co. (In re Woodson), 839 F.2d 610,
620 (9th Cir. 1988) (quoting In re A & C Props., 784 F.2d at 1381).

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

8 Bearing these points in mind, each of the A & C Properties factors weighs in
9 favor of authorizing of PG&E's entry into the Agreement and Release. RCN's
10 unequivocal inability and/or unwillingness to fulfill its obligations under the Master
11 Agreement coupled with CCSF's allegations that PG&E was not empowered to lease its gas
12 pipelines for telecom purposes would raise a number of potentially difficult disputed issues
13 if PG&E were to seek to enforce the Master Agreement against RCN. Litigating such issues
14 against RCN (and, potentially, CCSF) would undoubtedly prove time-consuming and costly,
15 and a successful legal outcome is by no means assured. Moreover, since RCN has
16 unequivocally defaulted on its payment obligations due to financial constraints, there is
17 significant doubt that pursuing litigation against RCN would result in any recovery.

18 Additionally, if PG&E had proceeded to terminate the Master Agreement, it
19 would have been required to refund 95% of the money RCN had paid to date anyway. For
20 only a small amount more than the amount it would have to pay upon termination, PG&E
21 obtains the benefit of mutual liability releases and a limitation on payment of any rejection
22 damages or interest. Therefore, rescinding the Master Agreement is a fair and equitable
23 resolution of potential disputes and in the best interests of PG&E's estate.
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1 **B. The Court Should Approve The Payment To RCN Under The Rescission**
2 **Agreement Pursuant To Section 363 Of The Bankruptcy Code Because**
3 **Sound Business Justifications Exist For The Refund.**

4 Moreover, the Court should approve the refund of \$873,170.72 to RCN pursuant
5 to its powers under Section 363(b)(1) of the Bankruptcy Code to authorize the use of estate
6 property.³

7 Pursuant to Section 363(b)(1), the court may authorize the debtor in possession to
8 use property of the estate “other than in the ordinary course of business.” In determining
9 whether to authorize a transaction under Section 363(b)(1), courts require a debtor to show
10 that a sound business purpose justifies such actions, applying the “business judgment” test.
11 See, e.g., Stephens Indus., Inc. v. McClung, 789 F.2d 386, 389-90 (6th Cir. 1986);
12 Committee of Equity Sec. Holders v. Lionel Corp. (In re Lionel Corp.), 722 F.2d 1063,
13 1063-64 (2d Cir. 1983); 3 Lawrence P. King, Collier on Bankruptcy §363.02[1][g] (15th ed.
14 rev. 1998).

15 The burden of establishing a valid business purpose for a transaction outside the
16 ordinary course of business falls upon the debtor. See In re Lionel Corp., 722 F.2d at 1070-
17 71. Once the debtor has articulated a rational business justification, however, a presumption
18 attaches that the decision was made on an informed basis, in good faith and in the honest
19 belief that the action was in the best interest of the debtor. See, e.g., Official Comm. of
20 Subordinated Bondholders v. Integrated Res., Inc. (In re Integrated Res., Inc.), 147 B.R. 650,
21 656 (S.D.N.Y. 1992) (citing Smith v. Van Gorkom, 488 A.2d 858, 872 (Del. 1985)).

22 As discussed in detail above, sound business justifications exist for PG&E to
23 rescind the agreement with RCN. Enforcing the Master Agreement is fraught with difficulty
24 and unlikely to result in a profitable outcome for PG&E. Moreover, the Rescission
25 Agreement allows PG&E to resolve or avoid disputes under the Master Agreement and

26 ³Arguably, PG&E’s decision to refund the money RCN has paid under the Master
27 Agreement to rescind a contract which has proved unlikely to benefit the company is within
28 the ordinary course of business for any enterprise. Thus, the payment may be made without
resort to the Court pursuant to Section 363(c)(1) of the Bankruptcy Code. However, to
eliminate any uncertainty, and to fulfill the terms of the Rescission Agreement, PG&E seeks
an Order of this Court pursuant to Section 363(b).

1 obtain a release of liability without the payment of interest or rejection damages for the
2 payment of a sum only slightly higher than PG&E was obliged to pay upon termination
3 based on RCN's default in any event. See Rescission Agreement, ¶¶ 4-5.

4 Accordingly, pursuant to its authority under Section 363(b)(1), the Court should
5 authorize PG&E to enter into the Rescission Agreement.

6 IV.

7 CONCLUSION

8 For all of the foregoing reasons, PG&E respectfully requests that this Court grant
9 the Motion and enter its Order approving the said Rescission Agreement and Mutual Release
10 as an appropriate compromise in the interests of the estate pursuant to Bankruptcy Rule 9019
11 and authorize the payment of \$873,170.72 pursuant to Section 363(b)(1) of the Bankruptcy
12 Code.

13 DATED: October ^{7th} 2002.

14 Respectfully,

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

16 By: 

17 CEIDE ZAPPARONI

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

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