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7

8 UNITED STATES BANKRUPTCY COURT  
9 NORTHERN DISTRICT OF CALIFORNIA

10  
11 In re  
12 PACIFIC GAS AND ELECTRIC  
COMPANY, a California corporation,

Case No. 01-30923 DM

Chapter 11 Case

13 Debtor.

Date: November 27, 2002

Time: 9:30 a.m.

14 Place: 235 Pine Street, 22nd Floor  
San Francisco, California

Judge: Hon. Dennis Montali

15 Federal I.D. No. 94-0742640

16  
17  
18 DEBTOR'S NOTICE OF MOTION AND MOTION FOR ORDER  
APPROVING EXPENDITURE OF FUNDS TO RETROFIT  
19 SIX LOW-PRESSURE TURBINES AT THE DIABLO CANYON POWER PLANT;  
20 SUPPORTING MEMORANDUM OF POINTS AND AUTHORITIES

21 [SUPPORTING DECLARATION OF LAWRENCE WOMACK FILED SEPARATELY]  
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HOWARD  
RICE  
NEMEROVSKI  
CANADY  
FALK  
& RABKIN  
A Professional Corporation

1 NOTICE OF MOTION AND MOTION

2 PLEASE TAKE NOTICE that on November 27, 2002, at 9:30 a.m., or as soon  
3 thereafter as the matter may be heard, in the Courtroom of the Honorable Dennis Montali,  
4 located at 235 Pine Street, 22nd Floor, San Francisco, California, Pacific Gas and Electric  
5 Company, the debtor and debtor in possession in the above-captioned Chapter 11 case  
6 ("PG&E" or the "Debtor"), will and hereby does move the Court (the "Motion") for entry of  
7 an order authorizing PG&E to enter into binding agreements and incur capital expenditures  
8 not exceeding \$110 million to retrofit six low-pressure turbines at its Diablo Canyon Power  
9 Plant ("DCPP") in support of a project known as the Diablo Canyon Turbine Retrofit Project  
10 (the "DCPP Turbine Retrofit Project") as more particularly described in the accompanying  
11 Memorandum of Points and Authorities incorporated by reference herein.

12 This Motion is made pursuant to Sections 105 and 363 of the United States  
13 Bankruptcy Code (11 U.S.C. §§105 & 363) and is based on the facts and law set forth in the  
14 attached Memorandum of Points and Authorities, the Declaration of Lawrence Womack  
15 filed concurrently herewith, the record of this case and any evidence presented at or prior to  
16 the hearing on this Motion.

17 PLEASE TAKE FURTHER NOTICE that this Motion is being noticed for  
18 hearing on ten (10) business days' notice pursuant to the above-captioned Court's Order Re  
19 Motion For Authority To Make Capital Expenditures In The Ordinary Course of Business  
20 dated June 29, 2001 (the "Omnibus Cap Ex Order"). The Omnibus Cap Ex Order does not  
21 specify the time for filing any written opposition to this Motion; nonetheless, because both  
22 the Court and PG&E should have the opportunity to review any written opposition to the  
23 Motion prior to the hearing thereon, parties in interest are advised to file any written  
24 opposition to the Motion and the relief requested therein with the Bankruptcy Court no later  
25 than two business days prior to the hearing, and to serve any such written opposition upon  
26 counsel for PG&E, the Office of the United States Trustee, and the Official Committee of  
27 Unsecured Creditors by hand service on the same date. If there is no timely objection to the  
28 requested relief, the Court may enter an order granting such relief without further hearing.

1 MEMORANDUM OF POINTS AND AUTHORITIES

2 I.

3 INTRODUCTION

4 By this Motion, Pacific Gas and Electric Company, the debtor and debtor in  
5 possession in this Chapter 11 case ("PG&E" or the "Debtor"), seeks an order pursuant to  
6 Sections 363 and 105 of the Bankruptcy Code (11 U.S.C. §§363 & 105)<sup>1</sup> authorizing PG&E  
7 to enter into binding agreements and incur capital expenditures not exceeding \$110 million  
8 to retrofit six low-pressure turbines at its Diablo Canyon Power Plant ("DCPP") in support  
9 of a project known as the Diablo Canyon Turbine Retrofit Project (the "DCPP Turbine  
10 Retrofit Project").

11 DCPP is a nuclear power plant located in San Luis Obispo County, California.  
12 The plant is the largest generating station on the PG&E electric system and provides power  
13 for over two million northern and central Californians from its two 1,100 megawatt units.  
14 The two units at DCPP utilize six low-pressure turbines and two high-pressure turbines to  
15 generate electricity. The low-pressure turbine rotors and blades have cracked, due to a  
16 design and/or workmanship flaw. In the 1990's, PG&E implemented a turbine maintenance  
17 program in response to this turbine degradation. The ongoing maintenance program  
18 includes extensive inspection, analysis and repair. Still, the low-pressure turbines must be  
19 retrofitted to avoid forced outages and to ensure the reliability of this critical generating  
20 resource. If the retrofitting is not done, there will be a significantly higher risk of forced  
21 outages. In addition to ensuring reliability, the retrofitting will bring the added benefit of  
22 increased efficiency. This is anticipated to increase DCPP's output by approximately 50  
23 megawatts.

24 PG&E brings this Motion because the requested \$110 million capital expenditure  
25 exceeds the project limit authorized without further Court approval in PG&E's Motion for  
26

27 <sup>1</sup>Unless otherwise indicated, all statutory references in this Motion are to the United  
28 States Bankruptcy Code (Title 11 of the United States Code).

1 Authority to Make Capital Expenditures in the Ordinary Course of Business filed in this case  
2 on June 6, 2001, which was approved pursuant to the Court's Order thereon dated June 29,  
3 2001 (such prior Motion and Order hereinafter are collectively referred to as the "Omnibus  
4 Cap Ex Motion and Order"). In broad outline, pursuant to the Omnibus Cap Ex Motion and  
5 Order, PG&E is authorized to proceed (a) without notice to or approval of the Court or the  
6 Official Committee of Unsecured Creditors (the "Committee"), with any project costing less  
7 than \$10 million, (b) with notice to and no objection by the Committee, with any project  
8 costing more than \$10 million and less than \$50 million, and (c) only upon a motion noticed  
9 to the Committee and the United States Trustee on at least 10 business days' notice and  
10 approval of the Court, with any project anticipated to cost more than \$50 million.

11  
12 II.

13 FACTUAL BACKGROUND<sup>2</sup>

14 A. The Diablo Canyon Turbine Retrofit Project.

15 The two units at DCPD each have a turbine generator train that consists of a high-  
16 pressure (HP) turbine, three low-pressure (LP) turbines and a generator/exciter. The six  
17 installed LP turbines were purchased in the late 1960s from Westinghouse Electric  
18 Corporation as part of DCPD's construction. In addition, PG&E purchased three location-  
19 specific LP turbine rotor spares in 1979. Each spare is interchangeable with one location  
20 (designated A, B and C) in either unit. As a result, there are presently three LP-A rotors,  
21 three LP-B rotors and three LP-C rotors. All nine of these rotors are experiencing stress  
22 corrosion cracking ("SCC") of the rotor in the blade attachment area and/or high cycle  
23 fatigue cracking of the blades themselves. The estimated remaining life of the rotors is three  
24 refueling cycles (approximately five years) or less. Maintenance costs are increasing  
25 dramatically, reliability is a concern and the risk of a forced outage due to blade detachment  
26

27 <sup>2</sup>The evidentiary basis and support for the facts set forth in this Motion are contained in  
28 the Declaration of Lawrence Womack, filed concurrently herewith.

1 has become more significant. As discussed below, some additional problems with the LP  
2 turbines have recently become apparent.

3 The DCPD Turbine Retrofit Project has been designed to address and remedy the  
4 problems with the LP turbines. More specifically, the DCPD Turbine Retrofit Project  
5 provides for the design, fabrication, delivery and installation of six LP Turbine retrofits.  
6 PG&E has conducted a competitive bidding process, and its team of engineering, business  
7 and technical experts have thoroughly evaluated various proposals. At the moment, PG&E  
8 is in final contract negotiations with a highly regarded multinational firm.

9 SCC in the blade attachment area of nuclear steam turbines has been an industry-  
10 wide problem with rotors of the design of those in use at DCPD.<sup>3</sup> To address this problem,  
11 PG&E has been performing major inspections, analyses and maintenance on the existing  
12 nine rotors. At each outage, PG&E removes one rotor and replaces it with a spare. The  
13 removed rotor is inspected for cracks, analyzed for estimated time to failure and repaired as  
14 necessary to restore a minimum level of short-term reliability. The repaired rotor is then  
15 used to replace the next rotor of identical design (LP-A, LP-B or LP-C) when that rotor is, in  
16 turn, removed for inspection, analysis and repair.

17 The maintenance program used to date merely monitors, and sometimes  
18 postpones, the time to failure. The program does not provide a long-term solution to the  
19 SCC problem. A long-term refurbishment fix for the SCC design defect would cost more  
20 than \$44,000,000 for the nine rotors. This type of approach would not address the additional  
21 problem of the high cycle fatigue design defect, discussed below.

22 In addition to the SCC problems on the rotor discs, DCPD is also experiencing  
23 numerous instances of high cycle fatigue ("HCF") in the blade roots, where the blades attach  
24 to the rotor. HCF cracking could result in one or more blades separating from the rotor.

25 \_\_\_\_\_  
26 <sup>3</sup>PG&E is currently involved in litigation with the supplier of the existing LP rotors,  
27 Siemens-Westinghouse Power Corporation (formerly Westinghouse). This litigation is not  
28 expected to have a material impact on the need for the proposed DCPD Turbine Retrofit  
Project.

1 This would most likely result in a forced shutdown and outage of 60 days or longer.

2 Because of the geometric constraints of the existing turbines, a long-term  
3 refurbishment fix addressing the HCF may not be possible. For the short term, PG&E has  
4 undertaken a program of increased inspections and major, temporary repairs, as necessary to  
5 restore a minimum level of acceptable reliability. The temporary repairs consist of complete  
6 replacement of selected rows of blades on each turbine rotor. This program reduces, but  
7 does not eliminate, the probability of a forced outage. While the program restarts the clock  
8 relative to time to failure, it does not fix the underlying problem. Continued DCP  
9 operation without LP turbine replacement would require periodic, repeated, full row blade  
10 replacements. The estimated cost of such a re-blading program is \$35,000,000.

11 Recently, one blade in a rotor with only one cycle of operation developed a crack.  
12 Crack morphology in progress may suggest that the current frequency of blade replacement  
13 is inadequate. If this is the case, maintenance expenditures would have to be increased. The  
14 HCF problem discussed above has only become apparent in the last few years. PG&E can  
15 likely expect additional problems with the turbine rotors in the future.

16 Nuclear power plants operate within strict regulations and are closely monitored.  
17 A turbine-failure-induced forced outage at DCP would be closely scrutinized by the  
18 Nuclear Regulatory Commission ("NRC"), the Institute of Nuclear Power Operations  
19 ("INPO"), the media and the general public. While there would be no nuclear safety risks  
20 associated with a turbine failure, the NRC would likely require PG&E to either shut down  
21 DCP's other unit to enable inspections of its turbine rotors, or demonstrate why a similar  
22 problem would not occur on that unit.

23  
24 B. Expected Cost Of PG&E's Contemplated Work.

25 On October 16, 2002, PG&E's Board of Directors approved a capital expenditure  
26 of \$110 million for the DCP Turbine Retrofit Project. These funds are expected to cover  
27 the anticipated work supporting the DCP Turbine Retrofit Project.

28 Based on PG&E's evaluation of bids submitted pursuant to a competitive bidding

1 process, PG&E estimates that the DCPD Turbine Retrofit Project will cost approximately  
2 \$110 million. Approximately \$700,000 is included in the 2002 budget, with the balance  
3 presently anticipated to be incurred in the next four years, consistent with the DCPD Retrofit  
4 Project's current targeted completion date in 2006.

5 The costs associated with the DCPD Retrofit Project were included in both the  
6 2003 General Rate Case filing before the California Public Utilities Commission and the pro  
7 forma financial analysis underlying PG&E's proposed Plan of Reorganization.

8  
9 III.

10 THE DIABLO CANYON TURBINE RETROFIT PROJECT  
11 SHOULD BE AUTHORIZED PURSUANT TO SECTIONS 363  
12 AND 105 OF THE BANKRUPTCY CODE.

13 As described in the Omnibus Cap Ex Motion, PG&E makes approximately \$1.5  
14 billion in capital expenditures annually in the ordinary course of its business. These capital  
15 expenditures cut across PG&E's utility functions, including the distribution and transmission  
16 of gas and electricity and the generation of electricity. PG&E's capital expenditures  
17 generally fall into one or more of three general categories: (1) emergency/safety projects;  
18 (2) projects mandated by regulatory or legal orders (including projects undertaken to remain  
19 in compliance with regulatory and legal requirements); and (3) other projects which may not  
20 be mandated by specific performance requirements, including projects designed to improve  
21 the reliability of PG&E's distribution and transmission systems. See Omnibus Cap Ex  
22 Motion at 3:19-4:4.

23 The DCPD Turbine Retrofit Project fits into category 3 above because it is a  
24 project designed to improve the reliability of PG&E's electric generation system.

25 As previously discussed in the Omnibus Cap Ex Motion, PG&E believes that  
26 expenditures on virtually all of its capital projects, as described above, are within the  
27 ordinary course of its business. As such, PG&E understands that such expenditures should  
28 be permitted without notice, hearing or any Bankruptcy Court approval, pursuant to 11  
U.S.C. Section 363(c). Recognizing, however, its rare position as a debtor in possession

1 required to make over \$1 billion in annual capital expenditures, PG&E has already agreed to  
2 apprise the Committee of capital expenditures above certain thresholds, and seek the Court's  
3 approval of any capital expenditure project over \$50 million. Although the DCPD Turbine  
4 Retrofit Project would be undertaken in the ordinary course of PG&E's business, PG&E  
5 asks for this Court's authority to proceed with the project, as its anticipated cost exceeds \$50  
6 million, and therefore requires a motion and Court approval, pursuant to the Omnibus Cap  
7 Ex Motion and Order.

8 PG&E has demonstrated in Part II above that the DCPD Turbine Retrofit Project  
9 is reasonable and appropriate to avoid forced outages and ensure reliability. This Court,  
10 therefore, can and should use its authority under Section 363 of the Bankruptcy Code to  
11 approve this capital expenditure.

12 Furthermore, Section 105(a) of the Bankruptcy Code authorizes this Court to  
13 "issue any order, process, or judgment that is necessary or appropriate to carry out the  
14 provisions of this title." Section 105 is meant to "assure the bankruptcy courts' power to  
15 take whatever action is appropriate or necessary in aid of the exercise of their jurisdiction."  
16 2 Lawrence P. King Collier on Bankruptcy ¶105.01 at 105-5 to 105-6 (15th ed. rev. 2000).  
17 For the reasons set forth above, the capital expenditure authorization for the DCPD Turbine  
18 Retrofit Project requested by the Motion will clearly serve the interests of the Debtor, its  
19 creditors and its customers, and will not violate any principle or precept of the Bankruptcy  
20 Code. Accordingly, pursuant to the Court's authority and discretion under Section 105(a) of  
21 the Bankruptcy Code, the Court can and should grant this Motion.

## 22 CONCLUSION

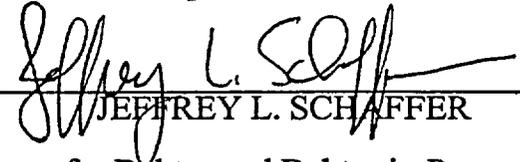
23 For all of the foregoing reasons, PG&E respectfully requests that this Court make  
24 and enter an order granting the Motion, thus authorizing PG&E to enter into contractual  
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28

1 commitments for, and incur the expenditure of funds up to, a maximum of \$110,000,000 in  
2 connection with the DCPD Turbine Retrofit Project.

3  
4 DATED: November 12, 2002.

5 Respectfully,

6 JAMES L. LOPES  
7 JEFFREY L. SCHAFFER  
8 HOWARD, RICE, NEMEROVSKI, CANADY,  
9 FALK & RABKIN  
10 A Professional Corporation

11 By:   
12 JEFFREY L. SCHAFFER

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14 PACIFIC GAS AND ELECTRIC COMPANY

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