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14 UNITED STATES BANKRUPTCY COURT

15 NORTHERN DISTRICT OF CALIFORNIA

16 (San Francisco Division)

17 In re) CASE NO. 01-30923 DM
18)
19) CHAPTER 11
PACIFIC GAS AND ELECTRIC)
20 COMPANY, a California) Date: November 18, 2002
Corporation,) Time: 9:30 a.m.
21)
22) UNITED STATES' TRIAL BRIEF IN
OPPOSITION TO CPUC'S PLAN OF
REORGANIZATION
23 Debtor.)

24 The United States of America, on behalf of its various agencies,
25 files its Trial Brief in Opposition to the Plan of Reorganization
26 propounded by the California Public Utilities Commission ("CPUC") and
27 the Official Committee of Unsecured Creditors, (the "CPUC Plan").
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1 to be issued under the plan, the proceeds of which are being used to
2 repay a portion of PG&E's indebtedness incurred during the energy
3 crisis. Id. Finally, the CPUC asserts that dismissal is appropriate
4 because of the substantial litigation risks that exist in the Rate
5 Recovery Litigation.

6 **Litigation Risks**

7 Among the litigation risks addressed in CPUC's Disclosure
8 Statement is the likelihood that the CPUC's motion to dismiss the
9 complaint and/or its motion for summary judgment will be granted.
10 Disclosure Statement at 60-61. Similarly, in the trial testimony of
11 its expert, Ashutosh Bhagwat, the CPUC reiterates that PG&E's claims
12 in the Rate Recovery Litigation face substantial risks on the merits.
13 Specifically, Mr. Bhagwat asserts that significant doubts exist as to
14 whether the filed rate doctrine will apply to the market based tariffs
15 which form the basis of PG&E's claims and, if so, whether the Supreme
16 Court's preemption decision in Nantahala Power & Light Co. v.
17 Thornburg, 476 U.S. 953 (1986), applies in this context.

18 The CPUC's arguments as to the substantial risks that PG&E faces
19 in the Rate Recovery Litigation, however, gloss over the fact that
20 the district court has already denied the CPUC's motions to dismiss
21 and for summary judgment. In so doing, the court considered and
22 summarily rejected the legal arguments now being advanced by Mr.
23 Bhagwat. In its lengthy and well-reasoned decision, the court held
24 that:

25 the filed rate doctrine applies here in much the same
26 way as it does under a cost-of-service regime. The
27 rule adopted by the court may be stated as follows:
28 costs of wholesale energy, incurred pursuant to rate
tariffs filed with FERC, whether these rates are
market-based or cost-based, must be recognized as

1 recoverable costs by state regulators and may not be
2 trapped by excessively low retail rates or other
limitations imposed at the state level.

3 In light of this rule, the novel features of
4 California's regulatory scheme are in some ways
ultimately irrelevant. Utilities must be able to
5 recover their wholesale costs incurred pursuant to
FERC-filed tariffs even when FERC allows sale of
6 wholesale electricity at prices the market will bear,
even when this federal approval is based in part on a
7 retail rate freeze and even when, as here, FERC
subsequently has determined that the market-based rates
were, at times, unreasonable.

8
9 Opinion at 43, Exhibit 2 to Bhagwat Report.

10 Thus, Mr. Bhagwat's suggestion that there are very powerful
11 arguments for not applying the filed rate doctrine to market based
12 tariffs is entitled to little weight. Similarly, his argument that a
13 court will not apply the Nantahala doctrine under these facts has been
14 proven wrong. This Court need look only to the holding of the
15 district court to determine that the CPUC's assessment of the
16 litigation risks posed by the Rate Recovery Litigation is faulty.

17 Recovery under the Suit

18 Similarly, the CPUC glosses over and ignores the amount of the
19 recovery PG&E is likely to win for the benefit of the estate. Judge
20 Walker's order denying the CPUC's motions to dismiss and for summary
21 judgment did leave open certain issues for trial, including the total
22 amount of undercollections, whether revenues received from different
23 sources could be applied to reduce the amount of undercollection and
24 whether revenues from the entire rate freeze period should be
25 considered. The CPUC fails to provide any legitimate basis for this
26 Court to conclude, however, that the paltry settlement CPUC proposes
27 is adequate. The CPUC states that the value of the revenues in excess
28 of costs that PG&E has been collecting from June 2001 through the

1 Effective Date equals approximately \$2.7 billion. CPUC Trial Brief at
2 17.¹ The CPUC further states that it will permit PG&E to recover in
3 rates the cost of the securities to be issued under the Joint Plan as
4 well as approximately \$1.75 billion of a regulatory asset that will
5 amortize over ten years. The CPUC estimates the value of the entire
6 settlement package at between \$2.75 billion and \$4.45 billion. CPUC
7 Trial Brief at 18. Thus, even under the CPUC's own self serving
8 calculations, it is settling the litigation for between \$4.7 and \$6.5
9 billion less than PG&E's claim. The CPUC fails to justify a
10 settlement involving such a drastic reduction in recovery to the
11 estate, particularly given the substantial financial feasibility
12 questions that exist with its plan.

13 Moreover, the CPUC fails to address the fact that even the \$2.75
14 billion it estimates as the value of the settlement may be illusory.
15 First, as set forth in PG&E's Trial Brief in Opposition to the CPUC
16 Plan, there is no assurance that future commissions will be bound by
17 the settlement. See PG&E Trial Brief at 3-10. In addition, the CPUC
18 ignores the legal cloud hanging over the \$2.75 billion recovery in
19 light of the Ninth Circuit's certification decision in Southern
20 California Edison Co. v. Lynch, 307 F.3d 794 (9th Cir. 2002). There,
21 the Ninth Circuit considered a settlement agreement between Southern
22 California Edison and the CPUC in the form of a stipulated judgment
23 setting rates at an amount sufficient to allow Edison to recover
24 substantially all of its past procurement costs. In considering that

25
26 ¹ Interestingly, however, the only source the CPUC provides
27 for this calculation is its own press release. Whether the CPUC
28 will be able to prove at confirmation that this figure is real
remains to be seen.

1 settlement, which is substantially similar to the settlement at issue
2 here -- but for the fact that the Edison settlement would pay Edison a
3 much greater recovery on its filed rate claim than PG&E's recovery --
4 the Ninth Circuit stated that serious questions existed as to whether
5 it violated state law, both in substance and the procedure by which
6 the CPUC agreed to it. "If so, then the Commission lacked capacity to
7 consent to the Stipulated Judgment, and we would be required to vacate
8 it as void." Id. at 809. Recognizing that the issue presented a
9 question of state, as opposed to federal law, however, the Ninth
10 Circuit certified the question of whether the stipulated judgment
11 violated state law to the California Supreme Court. If the California
12 Supreme Court agrees with the reasoning of the Ninth Circuit, the
13 settlement would be void and the \$2.75 billion of headroom would no
14 longer be available for payment to PG&E's creditors but would instead
15 be recoverable by ratepayers. Under that scenario, dismissal with
16 prejudice of the Rate Recovery Litigation and the loss of billions of
17 dollars owed to the estate, would provide no concomitant benefit for
18 creditors.

19 Conclusion

20 The CPUC's dismissal with prejudice of the Rate Recovery
21 Litigation against itself cannot be justified. Despite the statement
22 of the CPUC's legal "expert," no substantial legal questions exist as
23 to whether the filed rate doctrine and the related *Nantahala*
24 preemption rule can be applied to the claims asserted by PG&E.
25 Indeed, the district court already so held. In contrast, in light of
26 the Ninth Circuit's recent decision in Southern California Edison Co.
27 v. Lynch, substantial questions do exist as to whether any of the

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1 purported \$2.7 billion benefit to the estate under the settlement will
2 be available for creditors. Thus, the estate may receive no benefit
3 whatsoever from dismissal with prejudice of the multi-billion dollar
4 Rate Recovery Litigation. Moreover, even if the funds from the
5 headroom in rates are ultimately available for creditors, the CPUC
6 cannot establish that the \$4-6 billion give away proposed by the
7 settlement is justified.

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9 Respectfully submitted,

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