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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: December 23, 2002  
Time: 1:30 p.m.  
Place: 235 Pine Street  
San Francisco, California  
Judge: Hon. Dennis Montali

HOWARD  
RICE  
NEMEROVSKI  
CANADY  
FALK  
& RABKIN  
A Professional Corporation

NOTICE OF MOTION AND MOTION BY PACIFIC GAS AND ELECTRIC  
COMPANY FOR AN ORDER APPROVING SETTLEMENT OF DEBTOR'S  
CLAIMS AGAINST TRAVELERS PROPERTY AND CASUALTY ET AL.;  
MEMORANDUM OF POINTS AND AUTHORITIES IN SUPPORT THEREOF  
  
[SUPPORTING DECLARATION OF DAVID H. RUSH FILED SEPARATELY]

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1 MEMORANDUM OF POINTS AND AUTHORITIES

2 I. INTRODUCTION.

3 PG&E seeks Court approval of the proposed settlement (the "Settlement") of its  
4 claims against the Insurers and UTS as described below, pursuant to the terms of a  
5 settlement agreement, a copy of which is attached as Exhibit A to the Rush Declaration (the  
6 "Settlement Agreement"). The Settlement includes a total recovery to PG&E of  
7 \$1,500,000.00 and a release of the Insurers' claims against PG&E.

8  
9 II. FACTUAL BACKGROUND.<sup>1</sup>

10 The following is a summary of the events leading up to the litigation and of the  
11 terms of the Settlement. It is intended only as a brief overview of relevant facts.

12  
13 A. The Trauner Fire And PG&E's Claim For Indemnification Against Utility Tree  
14 Services, Inc.

15 On August 7, 1994, a fire occurred in the area of Rough and Ready, California  
16 (the "Trauner Fire"). The fire destroyed more than 700 acres, including several houses,  
17 barns and buildings.

18 At the time of the Trauner Fire, UTS was PG&E's independent tree trimming  
19 contractor in the area. The contract between PG&E and UTS required UTS to defend and  
20 indemnify PG&E for damages resulting from the work of the tree trimming contractor, other  
21 than damages resulting from the sole negligence or willful misconduct of PG&E.  
22 Accordingly, PG&E tendered its defense of the actions being filed against it by third parties  
23 to UTS. UTS refused PG&E's tender based on its assertion that the Trauner Fire was due to  
24 the sole negligence and/or willful misconduct of PG&E.

25 On November 7, 1994, PG&E filed an action against UTS and the Insurers in  
26 Nevada County Superior Court (assigned Case No. 52984) seeking indemnity, defense and

27 \_\_\_\_\_  
28 <sup>1</sup>The evidentiary basis and support for the facts set forth in this Motion are contained in  
the Rush Declaration.

13 HOWARD  
14 RICE  
15 NEMEROVSKI  
16 CANADY  
17 BALK  
18 & RABKIN  
19 A Professional Corporation

1 insurance coverage for the damages to PG&E as a result of the Trauner Fire. On May 18,  
2 1995, the parties agreed to submit this matter to binding arbitration.

3 The three-judge arbitration panel selected by the parties issued an award (the  
4 "Award") in favor of PG&E on April 2, 1996. The arbitrators determined that the Trauner  
5 Fire was not caused by the sole negligence or willful misconduct of PG&E, and therefore  
6 PG&E was entitled to full coverage, defense and indemnity for claims arising out of the  
7 Trauner Fire under the indemnity provisions contained in PG&E's contracts with UTS and  
8 the insurance policies issued by the Insurers. The arbitrators did not determine the amount  
9 owed to PG&E by UTS and the Insurers in the Award.

10 On May 20, 1996, PG&E initially filed its Petition to Confirm Arbitration Award  
11 (the "Petition to Confirm") with the Nevada County Superior Court. The Petition to  
12 Confirm was taken off calendar without prejudice while the parties engaged in extensive  
13 litigation with the victims of the Trauner Fire.

14  
15 B. The Action Against PG&E By Nevada County And The Claim By The Insurers  
16 In That Action

17 While this litigation was ongoing, the Nevada County District Attorney filed  
18 misdemeanor charges against PG&E for violation of certain Public Resource Code Sections,  
19 based upon the California Department of Forestry's determination that the Trauner Fire was  
20 caused by contact between a tree and an overhead PG&E distribution line. As a result of a  
21 trial in Nevada County Municipal Court, on July 30, 1997, the Court found PG&E liable and  
22 ordered it to pay full direct restitution to all persons who suffered economic losses as a result  
23 of the Trauner Fire (the "Restitution Order").

24 On November 6, 1997, the Insurers filed a claim in the criminal action against  
25 PG&E for restitution in the amount of \$4,654,318.45, for damages they allegedly sustained  
26 as a result of the Trauner Fire. On February 3, 1998, the Insurers filed an amended claim for  
27 restitution in the amount of \$6,254,318.45 plus interest at the rate of 10% per annum.  
28

1 C. PG&E and the Insurers Engage in Settlement Negotiations

2 PG&E refiled its Petition to Confirm on May 17, 2000. On May 26, 2000, the  
3 Superior Court confirmed the Award and scheduled an evidentiary hearing to enable PG&E  
4 to establish the actual damages to which it was entitled. That hearing was subsequently  
5 continued pending settlement negotiations between the parties.

6 On August 30, 2000, the Insurers and UTS filed a complaint for declaratory relief  
7 against PG&E, contending that California Insurance Code Section 533.5 precluded PG&E  
8 being awarded at least some of its damages pursuant to the Arbitration Award due to the  
9 Restitution Order.

10 On September 21, 2000, an offer was conveyed to PG&E by the Insurers and  
11 UTS to settle all of the foregoing claims. PG&E responded by requesting that the parties  
12 proceed to mediation.

13 Mediation was conducted on March 29, 2001, and August 30, 2001, before  
14 Joseph Ramsey.

15 In its Mediation Brief, PG&E requested the following damages:

16	Claims paid by PG&E to fire damage victims prior to arbitration	\$1,711,209.96
17	Monies paid to independent investigators, appraisers, 18 etc.	26,454.25
19	Adjusting expenses	63,672.50
20	Cost to repair damages to PG&E facilities	83,504.00
21	Payments for fire clean-up costs, tree removal, etc.	117,070.31
22	Attorneys' fees and costs	<u>113,532.62</u>
23	Total	\$2,115,443.64

24 Interest on the foregoing amounts was requested in the Mediation Brief at 10%  
25 per annum from and after April 2, 1996, the date of the award, through March 29, 2001, the  
26 date of the first mediation. Accordingly, the total damages requested by PG&E can be  
27 summarized as follows:

28

Principal	\$2,115,443.64
Interest	\$1,057,721.82
Total	\$3,173,165.46

In their Mediation Brief, the Insurers and UTS asserted the following defenses regarding their liability to PG&E:

1. PG&E's claim for reimbursement of monies paid to victims of the Trauner Fire should be dismissed because it violates Insurance Code Section 533.5 (providing that insurance policies may not cover payment of any restitution ordered in a criminal action) as well as California Civil Code Section 1668 (providing that contracts with the object of avoiding responsibility for violations of law are against public policy). In the alternative, the Insurers and UTS argued that even if the entire reimbursement claim was not eliminated, the claim should be reduced because the claims that PG&E settled that are included in its Petition to Confirm include liability for punitive damages, which are not subject to reimbursement.

2. PG&E's claim for damage to its property constitutes a contract claim, which is barred by the applicable statute of limitations.<sup>2</sup>

3. PG&E was not entitled to interest on three grounds: first, pre-judgment interest statutes do not apply to contractual arbitration; second, damages were not certain from the date on which the right to receive them vested because the arbitrators did not award a certain sum; and third, PG&E failed to diligently prosecute its Petition to Confirm and should not benefit from its lack of diligence.

The Insurers and UTS did not dispute PG&E's right to reimbursement of its costs for fire clean-up and tree removal, attorneys' fees and independent investigating, and adjusting expenses.

<sup>2</sup>At the mediation, however, there was no discussion of PG&E's claim for damages to its property.

1 D. The Parties Agree To A Settlement Agreement Subject To Bankruptcy Court  
2 Approval

3 On August 30, 2001 the parties entered into a preliminary mediation settlement  
4 agreement. The agreement was then formalized in the subsequent Settlement Agreement,  
5 which was signed by all parties on April 22, 2002. That Settlement Agreement is subject to  
6 the approval of this Court.

7 The Settlement Agreement contains, *inter alia*, the following material terms:

- 8 • The Insurers and UTS will pay to PG&E the total amount of \$1,500,000.00  
9 payable within 30 days of approval by the Bankruptcy Court.
- 10 • All parties completely release and discharge all claims arising from, or in any  
11 way connected with, the Trauner fire of August 7, 1994.

12 III. ARGUMENT.

13 A. The Settlement Should Be Approved Because It Is Fair And Equitable And In  
14 The Best Interests Of The Estate

15 “The law favors compromise and not litigation for its own sake . . . .” Martin v.  
16 Kane (In re A&C Properties), 784 F.2d 1377, 1381 (9th Cir. 1986). Bankruptcy courts have  
17 great latitude in approving compromise agreements that are “fair and equitable.” Woodson  
18 v. Fireman’s Fund Ins. Co. (In re Woodson), 839 F.2d 610, 620 (9th Cir. 1988). In passing  
19 on a proposed compromise, courts consider the following factors:

- 20 (a) The probability of success in the litigation; (b) the difficulties, if  
21 any, to be encountered in the matter of collection; (c) the complexity  
22 of the litigation involved, and the expense, inconvenience and delay  
23 necessarily attending it; (d) the paramount interest of the creditors and  
a proper deference to their reasonable views in the premises. (A&C  
Properties, 784 F.2d at 1381 (citation omitted))

24 PG&E has carefully considered the merits of its claims as well as its own  
25 exposure to claims by the Insurers and UTS, and concluded, in the exercise of its business  
26 judgement, that the settlement terms are fair and reasonable and that the relevant A&C  
27 Properties factors weigh in favor of settlement, as demonstrated below.

1 B. The Settlement Represents A Reasonable Compromise In Light Of The  
2 Uncertainty Of The Outcomes Of Legal Disputes And PG&E's Exposure To  
3 Restitution Claims By The Insurers

4 1. PG&E's Indemnity Claim And Interest Thereon

5 By far the largest portion of PG&E's damage claim against the Insurers and UTS  
6 is based on its payments of claims to victims of the Trauner Fire and interest accrued on  
7 such payments. Thus, the central issue in this litigation is the merit of PG&E's claim for  
8 reimbursement of these costs.

9 The arbitrators found that PG&E was entitled to indemnification and payments  
10 by the Insurers and UTS on the grounds that the Trauner Fire did not result from the sole  
11 negligence or willful misconduct of PG&E. However, the Insurers and UTS assert that this  
12 was purely a factual determination and did not address the legal question of whether or not  
13 the defendants are legally prevented from reimbursing PG&E based on the Restitution  
14 Order. PG&E does not agree with the argument by Insurers and UTS that California  
15 Insurance Code Section 553 precludes their liability to PG&E; however, PG&E  
16 acknowledges the possibility that such argument may prevail.

17 Additionally, the Insurers and UTS have argued, in the alternative, that at least  
18 twenty-five percent of PG&E's payments to victims is attributable to punitive damages  
19 claims. The Insurers and UTS argue that it is against the law to insure or indemnify for  
20 punitive damages and, therefore, PG&E's claim for reimbursement of payments made to  
21 victims must be reduced by 25%. PG&E disputes the Insurers' and UTS's contention that  
22 there is such a basis for reducing the amount owed to PG&E.

23 PG&E maintains that interest on its \$2.115 million damages claim is recoverable  
24 at the rate of 10% per annum from and after April 2, 1996. Approximately one-third of  
25 PG&E's total claim (or about \$1.057 million) is attributable to such interest. However,  
26 because the Award did not award a sum certain, the Insurers and UTS contend that PG&E  
27 cannot prevail on its interest claim. Such assertions are based on California Civil Code  
28 Section 3287, which provides that recovery of interest on damages must be certain or  
capable of being made certain by calculation from the date on which the right to receive

1 damages vests. PG&E disputes the Insurers' and UTS's contentions on this issue. Had the  
2 matter proceeded to litigation, PG&E would have argued that the amount of interest was  
3 capable of being made certain based on the claim information that PG&E previously  
4 produced to the Insurers and UTS.

5 However, in view of the uncertainty of the outcome of these legal disputes,  
6 PG&E has concluded that the Settlement payment to it of \$1.5 million represents a  
7 reasonable compromise.

8  
9 2. Release Of Claims Against PG&E

10 In the Settlement Agreement, the Insurers and UTS completely release and  
11 discharge PG&E and all related parties for any claims arising out of or in any way connected  
12 with the Trauner Fire. The Insurers previously filed a restitution claim in the amount of  
13 \$6,254,318.45 plus interest in connection with the Restitution Order. The elimination of  
14 PG&E's exposure to such restitution claims by the Insurers is of significant value to the  
15 estate.

16  
17 C. Continued Litigation Would Entail Unnecessary Expense And Delay

18 If this matter is not settled, PG&E faces ongoing litigation of both its claims  
19 against the Insurers and UTS, and the Insurers' claims against PG&E for restitution.  
20 Litigation of these two actions would presumably require PG&E to expend significant time  
21 and resources and may result in a smaller recovery by PG&E as compared with the  
22 Settlement and, perhaps, additional liabilities.

23  
24 D. The Settlement Benefits The Creditors

25 Avoidance of unnecessary litigation will benefit PG&E's creditors by avoiding  
26 the expense and delay of litigation and allowing PG&E's personnel to focus on more critical  
27 functions. The Settlement will add \$1.5 million to the estate and avoid the risk of a smaller  
28 recovery if the matter continued to be litigated. In addition, the Settlement provides a

1 substantial benefit to the estate by eliminating the Debtor's potential exposure to the multi-  
2 million dollar restitution claims by the Insurers.

3  
4 **CONCLUSION**

5 Based on all of the factors discussed above, the Debtor submits that Settlement is  
6 fair and equitable and in the best interest of the estate. The Settlement is advantageous in  
7 that it provides immediate and significant recovery on PG&E's claims, protects PG&E from  
8 exposure to significant claims against it and avoids the expense and uncertainty of litigation.  
9 Therefore, the settlement is optimal for PG&E and its estate.

10 Accordingly, PG&E respectfully requests that this Court enter its order approving  
11 the Settlement and authorizing PG&E to enter into and perform its obligations under the  
12 Settlement Agreement.

13 DATED: November 20, 2002.

14 HOWARD  
15 RICE  
16 NEMEROVSKI  
17 CANADY  
18 FALK  
19 & RABKIN  
20 A Professional Corporation

Respectfully,

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FALK & RABKIN  
A Professional Corporation

By:   
AMY L. BOMSE

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