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11 PACIFIC GAS AND ELECTRIC COMPANY

12  
13 UNITED STATES BANKRUPTCY COURT  
14 NORTHERN DISTRICT OF CALIFORNIA  
15 SAN FRANCISCO DIVISION

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

Case No. 01 30923 DM

Chapter 11 Case

Date: February 6, 2003

Time: 1:30 p.m.

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

21 NOTICE OF MOTION AND MOTION OF PACIFIC GAS AND ELECTRIC  
22 COMPANY FOR ORDER AUTHORIZING DEBTOR TO PAY CERTAIN  
23 REFUND OBLIGATIONS; MEMORANDUM OF POINTS AND  
24 AUTHORITIES IN SUPPORT THEREOF

25 [SUPPORTING DECLARATION OF LANETTE KOZLOWSKI FILED  
26 CONCURRENTLY HERewith]

27  
28  
*Asst  
add:  
Embarcadero*

1 NOTICE OF MOTION AND MOTION

2 PLEASE TAKE NOTICE that on February 6, 2003, at 1:30 p.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, pursuant to Sections 363  
7 and 105 of the Bankruptcy Code, for entry of an order authorizing the Debtor to pay certain  
8 refund obligations ordered by the Federal Energy Regulatory Commission ("FERC").

9 The Motion is based on this Notice of Motion and Motion, the accompanying  
10 Memorandum of Points and Authorities in support thereof, the Declaration of Lanette  
11 Kozlowski filed concurrently herewith, the record of this case and any evidence presented at  
12 or prior to the hearing on this Motion.

13 PLEASE TAKE FURTHER NOTICE that pursuant to Rule 9014-1(c)(2) of the  
14 Bankruptcy Local Rules for the United States District Court for the Northern District of  
15 California, any written opposition to the Motion and the relief requested therein must be  
16 filed with the Bankruptcy Court and served upon appropriate parties (including counsel for  
17 PG&E, the Office of the United States Trustee and the Official Committee of Unsecured  
18 Creditors) at least five (5) days prior to the scheduled hearing date. If there is no timely  
19 opposition to the requested relief, the Court may enter an order granting such relief without  
20 further hearing.

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HOWARD  
RICE  
NEMEROVSKI  
CANADY  
FALK  
& RAEBKIN  
A Professional Corporation

1 MEMORANDUM OF POINTS AND AUTHORITIES

2 I.

3 INTRODUCTION

4 Pacific Gas and Electric Company ("PG&E" or the "Debtor") hereby moves this  
5 Court for an order authorizing PG&E to effect refunds to certain of its customers pursuant to  
6 several final orders issued by, and two settlement agreements approved by, the Federal  
7 Energy Regulatory Commission ("FERC")<sup>1</sup>. Each of these settlement agreements and FERC  
8 orders reduced or reallocated charges previously passed on by PG&E to certain customers  
9 (pursuant to preliminary indications of approval from FERC) and ordered that PG&E refund  
10 customers accordingly. Some of these refund obligations can be addressed by adjustments  
11 and credits to customer accounts but others necessitate actual payment, as detailed below.  
12 While PG&E believes it will recover the vast majority of these charges, payment of the  
13 refund obligations will likely result in some reduction of revenues<sup>2</sup>.

14 As a highly regulated entity subject to FERC orders, PG&E strongly believes that  
15 effecting these refunds is in the ordinary course of its business. Nonetheless, out of an  
16 abundance of caution, PG&E seeks this Court's approval for the transactions.

17  
18 II.

19 FACTUAL BACKGROUND<sup>3</sup>

20 As explained in greater detail below, by this Motion, PG&E seeks permission to  
21 effect three categories of FERC-ordered refund obligations prior to confirmation of its Plan:  
22 (1) approximately \$110 million to its Transmission Owner Tariff customers ("TO Tariff  
23 Customers"); (2) approximately \$37 million to its Existing Transmission Contract customers

24 \_\_\_\_\_  
25 <sup>1</sup>These orders and settlement agreements are not attached as they are quite voluminous  
but will be made available to the Court and interested parties.

26 <sup>2</sup>PG&E does not expect these adjustments to have a material adverse effect on its  
results of operations or financial condition.

27 <sup>3</sup>The evidentiary basis and support for the facts set forth in this Motion are contained in  
28 the Declaration of Lanette Kozlowski filed concurrently herewith.

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1 (“ETC Customers”); and (3) approximately \$10.5 million to its wholesale TO Tariff  
2 Customers.

3 The California Independent System Operator Corporation (“CAL ISO”) imposes  
4 certain charges on PG&E and other utilities operating in the state. PG&E and the other  
5 utilities generally pass on these charges to their customers by adjusting rates. FERC  
6 provides very strict guidelines as to how the utilities can pass on these costs and which  
7 customers must bear the increased rates. FERC typically issues preliminary indications  
8 subject to later review and, if necessary, customer refunds. To settle disputes, FERC  
9 conducts extensive hearings and issues binding orders. Each of the refunds that PG&E now  
10 seeks authority to make to its customers results from a FERC order or a settlement  
11 agreement approved by FERC that modified a FERC preliminary indication. Because such  
12 orders and agreements are retroactive, it is common for the utility to make adjustments and  
13 refunds for past charges after they have been litigated or settled at FERC.

14 PG&E’s customers are divided into two general categories: ETC Customers and  
15 TO Tariff Customers. The ETC Customers are those customers who entered into binding  
16 long-term contracts with PG&E before the creation of the CAL ISO. These contracts require  
17 that PG&E file for authority to pass on CAL ISO charges to the ETC Customers under  
18 Federal Power Act (“FPA”) Section 205. The ETC Customers are primarily municipal  
19 utilities.

20 TO Tariff Customers, on the other hand, are subject to a current tariff that allows  
21 the pass-through of certain CAL ISO costs and so are obligated to reimburse PG&E for  
22 applicable charges under the CAL ISO Tariff, and PG&E’s TO Tariff. TO Tariff Customers  
23 are divided into two groups: wholesale and retail.

24 The refund obligations that PG&E now seeks authority to effect reflect charges  
25 imposed by the CAL ISO or changes to various rates or rate structures under PG&E’s TO  
26 Tariff or Reliability Services (“RS”) Tariff. Simply put, FERC has modified its preliminary  
27 indications and has held that PG&E must adjust the way it charged (or failed to charge)  
28 certain of its customer groups. Now, FERC has ordered PG&E to make the appropriate

1 adjustments. Because some of the reimbursements relate to pre-petition payments, PG&E  
2 seeks this Court's approval to effect the refunds.

3  
4 **A. TRBAA**

5 In connection with California's electric industry restructuring, the CAL ISO was  
6 established to provide operational control over most of the state's electric transmission  
7 facilities and to provide open access, on comparable terms and conditions, for electric  
8 transmission service. PG&E serves as the scheduling coordinator ("SC") under the CAL  
9 ISO Tariff to facilitate the continuing transmission service under certain of the ETC  
10 Customer contracts that PG&E entered into before the CAL ISO was established. The CAL  
11 ISO then bills PG&E, as the SC, for providing certain services associated with these  
12 contracts. These CAL ISO charges are referred to as SC costs ("SC Costs").

13 Since April 1, 1998, PG&E has included the SC Costs in its calculation of rates  
14 for TO Tariff Customers via an accounting mechanism known as the Transmission Revenue  
15 Balancing Account Adjustment ("TRBAA"). Recently, however, FERC held in its Opinion  
16 No. 458, issued August 5, 2002, that PG&E's use of the TRBAA mechanism resulted in its  
17 TO Tariff Customers paying for all of the SC Costs, while FERC concluded that some  
18 recovery of these costs should come from PG&E's ETC Customers. As a result, FERC  
19 ordered PG&E to refund the TO Tariff Customers approximately \$110 million, of which  
20 approximately \$75 million reflects pre-petition payments<sup>4</sup>. Because these refund obligations  
21 include pre-petition amounts in the approximate amount of \$75 million, PG&E seeks this  
22 Court's approval to effect the payments. This adjustment will not involve any cash layout

23  
24 <sup>4</sup>On November 12, 1999, PG&E filed a Scheduling Coordinator Services ("SCS")  
25 Tariff to collect SC Costs from the ETC Customers in the event FERC denied the TRBAA  
26 cost recovery mechanism. PG&E seeks to recover the full amount of the refunds except for  
27 approximately \$13.5 million related to certain congestion charges. PG&E believes it will be  
28 successful in recovering these refunds and litigation of the SCS Tariff will begin shortly.  
PG&E holds a reserve of \$63 million, to which the congestion charges and other  
unrecoverable refunds would be applied. PG&E does not expect the outcome of this  
proceeding to have a material adverse effect on its results of operations or financial  
condition.

1 by PG&E and will be effected solely through lower transmission rates to TO Tariff  
2 Customers in 2003.

3  
4 **B. RS Tariff**

5 The CAL ISO also imposes charges on PG&E and the state's other investor-  
6 owned electric utilities for certain expenses that the CAL ISO incurs in its efforts to ensure  
7 reliable electricity services. These charges are collectively referred to as Reliability Service  
8 Charges ("RS Charges"). Again, there is no dispute as to PG&E's right to pass the RS  
9 Charges on to its customers. As with the TRBAA above, the only contested issue has been  
10 which customers should bear the expenses.

11 Since June 29, 2000, PG&E has allocated the RS Charges to all of its customers,  
12 ETC and TO Tariff alike. Pursuant to its final order, Opinion No. 459, issued August 2,  
13 2002, FERC held that PG&E lacked authority to collect the RS Charges from its ETC  
14 Customers. As such, PG&E now seeks authority to refund the ETC Customers  
15 approximately \$37 million. This amount will be re-allocated and collected from retail TO  
16 Tariff Customers pursuant to a partial settlement approved by FERC.

17 Because approximately \$11 million of this \$37 million refund obligation relates  
18 to pre-petition payments, PG&E now seeks this Court's permission to refund its ETC  
19 Customers accordingly. The \$37 million refund cannot be effected via account credits and  
20 adjustments and requires a cash outlay by PG&E.

21  
22 **C. TO5 Rate Case And TAC Implementation Settlements**

23 On June 26, 2001, FERC approved a settlement of PG&E's fifth Transmission  
24 Owner Rate case ("TO5") which reduced PG&E's transmission rates. On February 27,  
25 2002, FERC approved a settlement (the "TAC Settlement") that had been entered into by  
26 PG&E and all parties to PG&E's Transmission Access Charge Implementation filing, which  
27 made changes to PG&E's TO Tariff to implement a new rate methodology adopted by the  
28 CAL ISO. The TAC Settlement incorporates certain changes to the rate design itself, rather

1 than PG&E's revenue requirement. Such alterations to the rate design have a direct impact  
2 on customer rates. Pursuant to the TAC Settlement, PG&E is obligated to refund  
3 approximately \$10.5 million to its wholesale TO Tariff Customers as a result of these  
4 changes in rate design and for the reductions in the transmission rates that stem from the  
5 TO5 settlement. This amount will be recovered through the TRBAA rate mechanism in  
6 2003 rates from TO Tariff Customers. Approximately \$9 million of the \$10.5 million refund  
7 relates to pre-petition payments. This refund cannot be effected via account credits or  
8 adjustments and requires a cash outlay by PG&E.

9  
10 **III.**  
11 **DISCUSSION**  
12

13 **A. PG&E Should Be Authorized To Pay The Refund Obligations In The**  
14 **Ordinary Course Of Business.**

15 Section 363(c)(1) of the Bankruptcy Code authorizes the Debtor to "enter into  
16 transactions, including the sale or lease or property of the estate . . . and . . . use property of  
17 the estate in the ordinary course of business without notice or a hearing." 11 U.S.C.  
18 § 363(c)(1). In light of the highly regulated nature of its industry, PG&E must abide by the  
19 rules of multiple regulatory agencies, including FERC on those matters for which FERC is  
20 the regulatory authority.

21 It is standard practice for FERC to approve utility rate changes on a preliminary  
22 basis, subject to later review and possible subsequent refunds. [See Kozlowski Decl. ¶ 3].  
23 Because PG&E is subject to FERC jurisdiction, it must abide by subsequent adjustments  
24 mandated by FERC. PG&E strongly believes that these adjustments are in the ordinary  
25 course of its business and can be undertaken without notice or a hearing.  
26  
27  
28

1           **B. PG&E Should Be Authorized To Pay The Refund Obligations Pursuant To**  
2           **Section 363(b)(1) Of The Bankruptcy Code On The Basis That It Makes**  
3           **Sound Business Sense To Pay These Categories Of Claims Pre-**  
4           **Confirmation.**

5           If the payments are not within PG&E's ordinary course of business, PG&E  
6           should be authorized to pay the three categories of refund obligations discussed above  
7           pursuant to Section 363(b)(1) of the Bankruptcy Code, which provides that "[t]he trustee,  
8           after notice and a hearing, may use, sell, or lease, other than in the ordinary course of  
9           business, property of the estate." 11 U.S.C. §363(b)(1).

10           In determining whether to authorize a transaction under Section 363(b)(1), courts  
11           require a debtor to show that a sound business purpose justifies such actions, applying the  
12           business judgment test. See, e.g., Stephens Indus., Inc. v. McClung, 789 F.2d 386, 389-90  
13           (6th Cir. 1986); Comm. of Equity Sec. Holders v. Lionel Corp. (In re Lionel Corp.), 722  
14           F.2d 1063, 1071 (2d Cir. 1983); see also 3 Lawrence P. King, Collier on Bankruptcy  
15           ¶363.02[1][g] (15th ed. rev. 1998).

16           The burden of establishing a valid business purpose for a transaction outside the  
17           ordinary course of business falls upon the debtor. See In re Lionel Corp., 722 F.2d at 1066.  
18           Once the debtor has articulated a rational business justification, however, a presumption  
19           attaches that the decision was made "on an informed basis, in good faith and in the honest  
20           belief that the action taken was in the best interest of the [debtor]." See, e.g., Official  
21           Comm. of Subordinated Bondholders v. Integrated Res., Inc. (In re Integrated Res., Inc.),  
22           147 B.R. 650, 656 (S.D.N.Y. 1992) (citing Smith v. Van Gorkom, 488 A.2d 858, 872 (Del.  
23           1985)).

24           Here, sound business justifications exist for PG&E's pre-confirmation payment  
25           of the refund obligations described above. Indeed, as a regulated electric utility, PG&E is  
26           obligated to submit to FERC jurisdiction and obey FERC orders. Moreover, PG&E will be  
27           able to resolve these three categories of obligations by effecting refunds totaling  
28           approximately \$157.5 million in total. As described above, most of these refunds should be  
recovered by the implementation of offsetting charges to other customer groups, or changes



1 in electric utility rates. Even if some net revenue loss results, PG&E is solvent and has the  
2 cash on hand to pay these claims without prejudice to other creditors<sup>5</sup>.

3  
4 **C. Payment Of The Refund Obligations Is Practical, “Legal And Factually  
5 Inevitable,” And In The Best Interests Of Creditors And The Estate; Thus  
6 The Court Should Order Such Payment Under Section 105 Of The  
7 Bankruptcy Code.**

8 Although courts demonstrate some reluctance in allowing payment of pre-petition  
9 claims prior to the confirmation of a plan in a Chapter 11 case, the Court has the power  
10 under Section 105 of the Bankruptcy Code to order the payment of pre-petition claims where  
11 circumstances warrant. In doing so, courts have been guided primarily by “practicality and  
12 common sense” and the “legal or factual inevitability of payment.” In re Payless Cashways,  
13 Inc., 268 B.R. 543, 547 (Bankr. W.D. Mo. 2001); In re EqualNet, 258 B.R. at 368.

14 Section 105 authorizes the court to “issue any order, process, or judgment that is  
15 necessary or appropriate to carry out the provisions of this title.” The purpose of Section  
16 105 is “to assure the bankruptcy court’s power to take whatever action is appropriate or  
17 necessary in aid of the exercise of its jurisdiction.” 2 Lawrence P. King, Collier on  
18 Bankruptcy ¶105.01, at 105-106 (15th ed. rev. 2000); see, e.g., Crafts Precision Indus., Inc.  
19 v. U.S. Healthcare, Inc. (In re Crafts Precision Indus., Inc.), 244 B.R. 178, 183 (B.A.P. 1st  
20 Cir. 2000) (affirming authorization of vacation payments “pursuant to §105, irrespective of  
21 them being non-priority obligations”); Michigan Bureau of Workers’ Disability Corp. v.  
22 Chateaugay Corp. (In re Chateaugay Corp.), 80 B.R. 279, 287 (S.D.N.Y. 1987) (bankruptcy  
23 court has equitable power, in pre-plan stage of reorganization proceeding, to authorize  
24 debtor-in-possession to pay pre-petition debt and to allow debtor to pay some creditors in  
25 class without paying others without violating Bankruptcy Code, as a “rigid application of the  
26 priorities of §507 would be inconsistent with the fundamental purpose of reorganization and

27 <sup>5</sup>The authorization sought by PG&E would benefit the estate by reducing post-petition  
28 interest costs and streamlining the claims resolution process, thereby allowing PG&E to  
focus those resources involved in the claims process on larger, more complex claims.

1 of the [Bankruptcy Code's] grant of equity powers to bankruptcy courts, which is to create a  
2 flexible mechanism that will permit the greatest likelihood of survival of the debtor and  
3 payment of creditors in full or at least proportionately"); see also In re Payless, 268 B.R. at  
4 547. As discussed above, the payments PG&E seeks authority to make have sound business  
5 justifications and are entirely appropriate.

6  
7 IV.  
8 CONCLUSION

9 For all of the foregoing reasons, PG&E respectfully requests that this Court enter  
10 its Order granting the Motion and such other and further relief as the Court deems just and  
11 appropriate.

12  
13 DATED: January 16, 2003.

14 Respectfully,

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

16  
17 By: 

18 WILLIAM J. LAFFERTY

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

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