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12 PACIFIC GAS AND ELECTRIC COMPANY

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 Case No. 01-30923 DM

21 Chapter 11 Case

22 Date: February 27, 2003

23 Time: 1:30 p.m.

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

26 Federal I.D. No. 94-0742640

27 NOTICE OF MOTION AND MOTION FOR AUTHORITY TO INCUR  
28 POST-PETITION SECURED DEBT IN CONNECTION WITH NATURAL  
GAS TRANSPORTATION AGREEMENT WITH PG&E GAS  
TRANSMISSION, NORTHWEST CORPORATION; MEMORANDUM OF  
POINTS AND AUTHORITIES IN SUPPORT THEREOF

[SUPPORTING DECLARATION OF MICHAEL G. WHITE FILED SEPARATELY]

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HOWARD  
RICE  
NEMEROVSKI  
CANADY  
FALK  
& RABKIN  
A Professional Corporation

1           **PLEASE TAKE NOTICE** that on February 27, 2003 at 1:30 p.m., or as soon  
2 thereafter as the matter may be heard, in the Courtroom of the Honorable Dennis Montali,  
3 located at 235 Pine Street, 22nd Floor, San Francisco, California, Pacific Gas and Electric  
4 Company, the debtor and debtor in possession in the above-captioned Chapter 11 case  
5 (“PG&E”), will and hereby does move the Court for authority to incur post-petition secured  
6 debt in connection with a natural gas transportation agreement between PG&E and PG&E  
7 Gas Transmission, Northwest Corporation (“GTN”).

8           This Motion is based on this Notice of Motion and Motion, the accompanying  
9 Memorandum of Points and Authorities, the Declaration of Michael G. White filed  
10 concurrently herewith, the record of this case and any evidence presented at or prior to the  
11 hearing on this Motion.

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

1 **MEMORANDUM OF POINTS AND AUTHORITIES**

2 PG&E requests authority, pursuant to 11 U.S.C. Section 364, to incur post-  
3 petition secured debt in connection with a natural gas transportation agreement with GTN, as  
4 described further below.

5  
6 **I. FACTUAL BACKGROUND**<sup>1</sup>

7 PG&E filed a voluntary petition for relief under Chapter 11 of the Bankruptcy  
8 Code on April 6, 2001. A trustee has not been appointed, and PG&E continues to operate its  
9 business as a debtor in possession pursuant to Sections 1107 and 1108 of the Bankruptcy  
10 Code.

11  
12 **A. GTN's Natural Gas Transportation Services and Request for Collateral Related Thereto.**

13 Pursuant to a Firm Transportation Service Agreement dated October 26, 1993  
14 (the "Service Agreement") between PG&E and GTN,<sup>2</sup> GTN transports natural gas supplies  
15 purchased by PG&E in Canada. These gas supplies are transported through GTN's pipeline  
16 (located at the border of British Columbia, Canada and Idaho) to the Oregon-California  
17 border, where the pipeline connects with PG&E's California gas transmission system. The  
18 Service Agreement requires GTN to provide PG&E with 609,968 decatherms per day of  
19 transportation (a decatherm is equal to 100,000 British thermal units). Pursuant to the  
20 Service Agreement, PG&E pays GTN a fixed monthly reservation fee to reserve the right to  
21 use the foregoing capacity and also pays GTN volumetric fees based on the actual quantities  
22 transported each month. Currently, the fixed monthly reservation fee is approximately \$4.6  
23 million.

24 PG&E has utilized GTN to transport natural gas supplies purchased in Canada

25  
26 <sup>1</sup> The evidentiary basis and support for the facts set forth in this Motion are contained  
in the Declaration of Michael G. White filed concurrently herewith ("White Declaration").

27 <sup>2</sup> GTN is a subsidiary of PG&E National Energy Group, Inc., which is a wholly-owned  
28 subsidiary of PG&E Corporation, the parent corporation of PG&E.

1 since 1961. Canadian gas supplies comprise approximately 70% of PG&E's natural gas  
2 portfolio, from which PG&E serves more than 3 million core gas customers.

3 Pursuant to a GTN tariff approved by the Federal Energy Regulatory  
4 Commission or "FERC" (the "Tariff"), there are credit requirements for "Shippers" such as  
5 PG&E contracting for gas transportation services with GTN. These credit requirements  
6 specify that GTN shall not be required to perform or to continue transportation services on  
7 behalf of any Shipper that is or becomes insolvent, or who fails within a reasonable period of  
8 time to establish or confirm creditworthiness. Shippers who fail to meet the creditworthiness  
9 requirements have the option of providing a guarantee of financial performance or providing  
10 security acceptable to GTN.<sup>3</sup>

11 As a result of the downgrading of PG&E's credit rating in January 2001, GTN  
12 requested and obtained collateral from PG&E in the amount of \$11.4 million on or about  
13 January 10, 2001. This amount represented approximately three months of fixed reservation  
14 fees as well as three months of estimated volumetric fees under the Service Agreement, at  
15 the rates in effect as of January 2001. Effective November 1, 2002, GTN increased the  
16 reservation rate under the Service Agreement, pursuant to a FERC-approved tariff, by  
17 approximately \$930,000 per month. As a result, the \$11.4 million previously deposited as  
18 collateral is no longer sufficient to cover three months of fees under the Service Agreement.  
19 Therefore, GTN has requested an additional \$2,783,457 to be deposited with GTN as  
20 collateral.<sup>4</sup>

21  
22  
23 <sup>3</sup> A copy of the relevant portion of the Tariff is attached as Exhibit A to the White  
Declaration.

24 <sup>4</sup> PG&E has requested that the collateral amount be deposited into an escrow or other  
25 segregated account with GTN. GTN has indicated that it is not willing to segregate these  
26 funds and that it does not segregate similarly situated collateral received from other  
27 Shippers. However, GTN has confirmed in writing that these funds are being held as  
28 collateral to secure PG&E's obligations under the Service Agreement. Nevertheless, the  
absence of a segregated account for these funds may expose PG&E to certain risks in  
connection with obtaining the return of the collateral in the event that GTN failed to comply  
with its obligation to return the collateral to PG&E.

1                   **B. Adequate Protection of Senior Indebtedness.**

2                   The indenture trustee for certain mortgage bonds issued by PG&E (the “Indenture  
3 Trustee”), who holds a lien on substantially all of PG&E’s assets for the benefit of the  
4 mortgage bondholders, is fully secured and adequately protected by a substantial equity  
5 cushion. The Indenture Trustee has indicated that it has no objection to this Motion  
6 provided that PG&E can establish that its interests are adequately protected. It is undisputed  
7 that the indebtedness held by the mortgage bondholders is adequately protected by a  
8 substantial equity cushion. See Motion for Order Modifying Stipulation: (i) Authorizing  
9 Use of Cash Collateral, etc. and Declaration of Kent Harvey filed in support thereof on  
10 February 1, 2002 as Docket Nos. 4577 and 4578 (establishing that PG&E’s total assets  
11 exceeded the unpaid bond indebtedness by more than \$20 billion). See also PG&E’s  
12 Monthly Operating Report for the month ended November 30, 2002 (filed on December 30,  
13 2002), reflecting total assets of approximately \$25 billion. Since the filing of the above-  
14 referenced cash collateral motion, the amount of the unpaid bond indebtedness has decreased  
15 while PG&E’s total assets remain at approximately \$25 billion.

16  
17                   **II.**  
18                   **PG&E SHOULD BE AUTHORIZED TO INCUR THE POST-PETITION SECURED**  
19                   **DEBT PURSUANT TO BANKRUPTCY CODE SECTION 364**

20                   Bankruptcy Code Section 364(d)(1) provides, in pertinent part, as follows:

21                   The Court, after notice and a hearing, may authorize the obtaining of  
22                   credit or the incurring of debt secured by a senior or equal lien on  
23                   property of the estate that is subject to a lien only if—

24                   (A) the trustee is unable to obtain such credit otherwise; and

25                   (B) there is adequate protection of the interest of the holder of the lien  
26                   on the property of the estate on which such senior or equal lien is  
27                   proposed to be granted. (11 U.S.C. §364(d)(1))

28                   Thus, the only statutory prerequisites for obtaining credit on a senior secured  
basis is that the debtor be unable to obtain such credit otherwise, and that there be adequate  
protection for the existing lienholder. This test is clearly satisfied in this case. As discussed  
above, PG&E cannot arrange for necessary gas transportation services without meeting

1 GTN's creditworthiness requirements. The GTN Tariff permits GTN to stop performing  
2 services unless security is provided, in the absence of meeting the creditworthiness  
3 requirements. Furthermore, the only existing potential lienholder (the Indenture Trustee) is  
4 fully secured and adequately protected by a substantial equity cushion.

5 In determining whether to approve a transaction under Section 364, courts act in  
6 their "informed discretion." In re Ames Dep't Stores, Inc., 115 B.R. 34, 37 (Bankr.  
7 S.D.N.Y. 1990). Courts have established that such discretion is to be utilized to permit the  
8 debtor's reasonable business judgment to be exercised so long as the financing agreement  
9 does not contain terms that are primarily designed to benefit the secured party at the expense  
10 of the estate or leverage the bankruptcy process. Id. at 39-40; In re Simasko Prod. Co., 47  
11 B.R. 444, 449 (D. Colo. 1985). In undertaking such analysis, courts focus on the following  
12 principal factors: proposed terms that would tilt the conduct of the bankruptcy case;  
13 prejudice, at the early stages, to the powers and rights that the Bankruptcy Code confers for  
14 the benefit of all creditors; or terms that leverage the Chapter 11 process by preventing  
15 motions by parties in interest from being decided on their merits. In re Tenney Village Co.,  
16 Inc., 104 B.R. 562, 567-70 (Bankr. D.N.H. 1989); Norris Square Civic Ass'n v. St. Mary  
17 Hosp. (In re St. Mary Hosp.), 86 B.R. 393, 401-02 (Bankr. E.D. Pa. 1988); In re Crouse  
18 Group, Inc., 71 B.R. 544, 550-51 (Bankr. E.D. Pa. 1987).

19 As discussed above, PG&E seeks to deposit the \$2,783,457 in order to satisfy  
20 GTN's creditworthiness requirements. This financing will allow PG&E to continue to serve  
21 its gas customers by obtaining necessary natural gas transportation services. PG&E believes  
22 that the amount of collateral to be posted as security is reasonable as it is calculated to cover  
23 approximately three months of fees under the Service Agreement. Accordingly, the Court  
24 should authorize PG&E to incur post-petition secured debt in favor of GTN under Section  
25 364.

1 **CONCLUSION**

2 Based on the foregoing, PG&E respectfully requests authority to incur post-  
3 petition secured debt in the amount of \$2,783,457 in favor of GTN, pursuant to 11 U.S.C.  
4 Section 364, and that the Court grant such other and further relief as may be just and  
5 appropriate.

6  
7 DATED: January 30, 2003

Respectfully,

8 HOWARD, RICE, NEMEROVSKI, CANADY,  
9 FALK & RABKIN  
A Professional Corporation

10 By: Julie Landau  
11 JULIE B. LANDAU

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