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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: February 27, 2003 Time: 1:30 p.m. Place: 235 Pine Street, 22nd Floor San Francisco, California

NOTICE OF FOURTH MOTION AND FOURTH MOTION FOR AUTHORITY TO INCUR MISCELLANEOUS IMPLEMENTATION EXPENSES; MEMORANDUM OF POINTS AND AUTHORITIES IN SUPPORT THEREOF

[SUPPORTING DECLARATIONS OF MICHAEL SCHONHERR, STEPHANIE MAGGARD, MY NGUYEN, LANCE MAEDA AND BRUCE BOWEN FILED SEPARATELY]

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NOTICE OF MOTION AND MOTION

PLEASE TAKE NOTICE that on February 27, 2003 at 1:30 p.m., or as soon thereafter as the matter may be heard in the Courtroom of the Honorable Dennis Montali, located at 235 Pine Street, 22nd Floor, San Francisco, California, Pacific Gas and Electric Company, the debtor and debtor in possession in the above-captioned Chapter 11 case ("PG&E"), will and hereby does move the Court for entry of an Order Approving Fourth Motion for Authority to Incur Miscellaneous Implementation Expenses (the "Motion").

This Motion is based on this Notice of Motion and Motion, the accompanying Memorandum of Points and Authorities, the Declarations of Michael Schonherr, Stephanie Maggard, My Nguyen, Lance Maeda and Bruce Bowen, filed concurrently herewith, the record of this case and any evidence presented at or prior to the hearing on this Motion.

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

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MEMORANDUM OF POINTS AND AUTHORITIES

Pacific Gas and Electric Company, the debtor and debtor in possession in the above-captioned Chapter 11 case ("PG&E"), requests an order authorizing PG&E to incur additional miscellaneous implementation expenses related to implementation of PG&E's proposed Plan of Reorganization, pursuant to Bankruptcy Code Section 363(b)(1).

I. FACTUAL BACKGROUND

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

PG&E, together with its parent corporation, PG&E Corporation, has proposed a Plan of Reorganization (as amended from time to time, the "Plan"), which is currently being considered for confirmation. The Plan generally provides for the creation of three new companies, ETrans LLC, GTrans LLC and Electric Generation LLC (collectively, the "New Entities"), whereby PG&E will separate its operations into four lines of business based on PG&E's historical functions. Accordingly, the Reorganized Debtor (referred to herein as "PG&E") will continue the retail gas and electric distribution business, ETrans will operate the electric transmission business, GTrans will operate the interstate gas transmission business, and Electric Generation will operate the electric generation business.

PG&E has previously filed and obtained orders approving various motions seeking authority to incur costs related to implementation of the Plan. The present Motion seeks approval for approximately $3.8 million in additional implementation-related expenses.[1] PG&E has made substantial progress in completing previously-approved

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[1] In the Motion for Authority to Incur Information Technology Consulting Expenses filed on July 23, 2002, PG&E identified additional Plan implementation projects that would need to commence before the Plan is confirmed and estimated that the total expenses for these projects would range from $10.8 to $17.8 million. Since that time, PG&E has obtained approval for approximately $8.7 million in additional implementation project expenses. In addition, PG&E obtained approval on February 6, 2003 to incur approximately $67,500 per month for lease extension fees related to implementation.

implementation projects and anticipates that, for the majority of these projects, its spending will be within or below the approved amounts. However, for certain projects, as better information became available during the course of work, PG&E has identified new required tasks or the need to increase the scope of previously identified tasks. Therefore, many of the expenses described in this Motion involve additional costs related to specific projects that have been the subject of previous implementation expense motions approved by the Court.

A. Additional Accounting Expenses (Cost Estimate: $800,000).[2]

PG&E previously filed a Motion for Authority to Incur Additional Miscellaneous Implementation Expenses on September 12, 2002, which was approved by Order entered on October 2, 2002. The motion included expenses of $1.5 million to be incurred by PG&E in connection with PricewaterhouseCoopers' ("PWC") development of accounting processes and procedures for the New Entities. PG&E now anticipates that this project will require approximately $800,000 in additional expenses.

As described in the previous motion, by the Effective Date under the Plan ("Plan Effective Date"), the New Entities will require accounting systems and applications that are fully implemented and operational in order to commence business operations, including the maintenance of books and records. These accounting systems and applications require associated processes and procedures to capture, record and validate all transactions. Since October 2002, PWC has been assisting PG&E in reviewing its existing accounting processes and procedures and in the development of new processes and procedures for use by the New Entities. While the project has not changed since the previous motion was filed, it has become better defined and quantifiable as a result of the work that has been performed by PWC for the last four months. There are over 82 individual accounting processes to be reviewed and adapted for use by the New Entities. Initially, PG&E identified approximately 70 individual accounting processes that needed to be reviewed and adapted for use by the

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[2] See Declaration of Stephanie Maggard filed concurrently herewith.

New Entities. Also, PG&E now understands that many of these processes are more complex to document than originally anticipated, or require more substantial modification for use by the New Entities than previously anticipated. As a result, PWC will incur additional fees completing the services. PG&E therefore requests authority to incur approximately $800,000 in additional costs for this project.[3]

B. <u>Additional Land-Related Expenses (Cost Estimate: $1.5 million)</u>.[4]

PG&E previously filed a Motion for Authority to Incur Land-Related Expenses on April 12, 2002 (the "Land Motion"), which was approved by Order entered on May 17, 2002. PG&E subsequently filed its Third Motion for Authority to Incur Miscellaneous Implementation Expenses (the "Third Miscellaneous Motion") on October 18, 2002, which included additional land-related expenses (at pp. 4-6) and was approved by Order entered on November 8, 2002. The Land Motion described expenses to be incurred by PG&E in connection with title review and analysis, and survey work, for a total estimated cost of $5.5 million, while the Third Miscellaneous Motion disclosed additional land-related work for a an estimated cost of $750,000. As stated in the Land Motion, this work arises out of PG&E's large portfolio of real estate assets, including approximately 250,000 acres of land, more than six million square feet of support service space (service centers, offices and warehouses) and hundreds of real property leases (collectively, the "Land"), along with thousands of related real property rights, including: rights-of-way and easements, prescriptive rights, possessory interests, unrecorded rights and other land-related agreements, and associated maps and drawings (collectively, the "Land Rights"). This work is necessary to prepare for the transfers of Land and Land Rights to the New Entities in connection with

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[3] PWC and each of the other consultants described below are subject to PG&E's standard contractual provisions, which do not guarantee future work or any minimum amount of revenue. Except as specifically noted otherwise, PG&E maintains the right to terminate the work at any time without cause, in which case PG&E is liable only for work performed to the date of termination plus costs reasonably incurred by the consultant in terminating any work in progress.

[4] <u>See</u> Declaration of Michael Schonherr filed concurrently herewith.

the implementation of the Plan.

Since the Land Motion and Third Miscellaneous Motion were filed, PG&E has determined that the land-related work to be performed by the contractors will require more time than previously estimated. The nature of the work has not changed from that described in the Land Motion and Third Miscellaneous Motion and will be completed by the same consultants identified in the prior motions. However, PG&E estimates that the completion of this project could require approximately $1.4 million in additional expenses, as described in Section B.1 below. Section B.2 below describes a new project that has been identified as necessary to commence prior to Plan confirmation and is related to the Land and Land Rights' transfers, with an estimated cost of $100,000.

1. Additional Land and Land Rights Analysis and Reconciliation. The work described in the Land Motion and Third Miscellaneous Motion has not changed but has proven to be more substantial and complex than PG&E had previously estimated. First, more exhibits, maps, title descriptions and other documents pertaining to Land Rights were needed than previously contemplated, in connection with both transfer agreements and various regulatory filings. Second, the title analysis work associated with gas-related assets and telecommunications facilities has resulted in increased costs. For example, the records for most of the new gas lines identified for transfer are not centrally stored or managed and therefore, the process of locating these records has involved more of the contractors' time than previously anticipated; in addition, increased contractor time has been required in assessing the Land Rights associated with the gas lines and determining how these Land Rights should be transferred. These problems were not known until PG&E and the contractors located and examined various documents. Third, PG&E and its contractors found that the work associated with the properties to be divided between ETrans and PG&E under the Plan (including subdivision and lot line adjustments and title analysis work) was also more complex than previously anticipated. Based on the foregoing, PG&E estimates that an additional $1.4 million in expenses will be incurred in connection with the work associated with the transfer of Land and Land Rights.

2. Development of a Real Estate Recording Plan. The transfers of Land and Land Rights to the New Entities in connection with the implementation of the Plan will involve real estate assets located in 47 counties in California and in Klamath County, Oregon. Real estate documents transferring these assets to each of the New Entities will need to be recorded with each county recorder's office on the Plan Effective Date. Because the volume of documents to be recorded is large (approximately 10,000 pages for the 48 counties), the process of timing and sequencing of the recording will be complex. PG&E believes it is imperative to begin planning for these activities now so that a comprehensive plan can be developed well in advance of the Plan Effective Date. The development of a real estate recording plan is expected to take up to three months.

PG&E has selected NSI Consulting & Development, Inc. ("NSI") to develop a detailed plan for the timely and accurate recording of the real estate transfer documents. NSI is a real estate consulting firm with expertise in assisting utilities with separation of land and land rights related to the disaggregation of transmission and distribution businesses, such as would be required for PG&E upon Plan confirmation. PG&E will work with NSI to develop prototype packages for presentation to a few test counties. Based on feedback received from the initial discussions with the test counties, NSI will work with PG&E to develop final standardized recording packages for each county. NSI will then coordinate with each county to develop the form, content and final process (including the payment of all required fees and expenses) for recording the real estate transfer documents, ensuring that all parties are prepared to take the necessary steps to successfully transfer the Land and Land Rights by the Plan Effective Date. PG&E estimates that the cost for NSI's services will be approximately $100,000.

C. **Additional Facility Separation Costs (Cost Estimate: $626,300).**[5]

In the Third Miscellaneous Motion, PG&E explained that, in connection with

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[5] See Declaration of My Nguyen filed concurrently herewith.

implementation of the Plan, it anticipated: (i) leasing seven new buildings, which would need to be prepared for occupancy by the New Entities, and (ii) modifying 30 existing PG&E-owned buildings for use by PG&E and the New Entities.[6] PG&E obtained authority to incur $425,000 in connection with hiring construction project managers in order to prepare the new buildings for occupancy and to modify the existing PG&E buildings to serve multiple entities. PG&E explained that actual construction would not take place until after confirmation of the Plan, but that the construction project managers were needed in order to assess the construction needs and plan for the construction work. Specifically, the preliminary work includes: (i) determining the scope of work for each building; (ii) preparing and submitting local building permit and conditional use permit applications; (iii) development of detailed site-specific work schedules; and (iv) preparing contract specifications, selecting qualified contractors, and negotiating contract terms. Set forth in Section C.1 below is a description of additional costs of approximately $535,000 that PG&E now anticipates will be incurred in connection with the construction project managers.

Also in the Third Miscellaneous Motion, PG&E obtained authority to incur $100,000 in pre-construction costs related to permits and engineering, noting: "Until the construction project managers . . . begin work, PG&E will not have a precise estimate of the total pre-construction costs." (at p. 8:13-14). Set forth in Section C.2 below are additional pre-construction projects for total additional expenses of approximately $91,300.

1. <u>Additional Costs for Construction Project Managers</u>. Since November 2002, PG&E has discovered that the pre-construction planning work will be more extensive and time-consuming than originally estimated at the project's inception. Now that PG&E has identified specific buildings to lease (as described in the Lease Extension Motion), and as planning has progressed in preparing existing PG&E buildings and sites for occupancy by

[6] More recently, PG&E filed the Motion for Authority to Incur Lease Extension Fees on January 17, 2003 (the "Lease Extension Motion"), identifying six specific properties to be leased by the New Entities, for which PG&E requested authority to pay lease extension fees to retain the right to enter into long-term leases for these properties upon Plan confirmation.

the New Entities, it has become clear that more work will be required of the construction project managers. For example, instead of using trailers on existing PG&E sites to house certain employees and functions of the New Entities, as originally planned, six of the PG&E sites will require the construction of new metal buildings since PG&E has determined that the trailers cannot accommodate the space needs of the groups targeted to occupy them. Furthermore, at many of the existing PG&E buildings, more substantial modifications will be required than originally anticipated to prepare these facilities to be shared by employees of PG&E and employees of the New Entities. Therefore, PG&E now estimates that an additional $535,000 will be required to enable the construction project managers to complete the pre-construction planning tasks.

2. Additional Site Preparation Costs. The costs described in subsections a. and b. below, once incurred, will not be recoverable or subject to termination as these costs are not subject to the standard contractual provisions of PG&E's consulting agreements summarized in footnote 3 above.

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a. Woodland Site. At the Woodland site (described at page 7 of the Lease Extension Motion), PG&E has identified the need to obtain switching devices for telephone lines and telecommunications equipment for a total cost of approximately $36,300.[7] Although this property is not yet subject to a long-term lease by PG&E, it has been identified as a critical site to lease and was therefore included in the Lease Extension Motion. Orders must be placed promptly for the switching device ($6,300) and telecommunications equipment ($30,000) because several months' lead time is required to obtain the necessary equipment and allow time to install the telecommunications infrastructure. The telecommunications infrastructure must be in place by the time construction at the site begins, which is expected to occur promptly after Plan confirmation.

b. Vaca-Dixon Substation. PG&E anticipates that the Vaca-Dixon

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[7] In the event that Plan implementation does not occur or the Woodland site is not ultimately leased by PG&E, PG&E anticipates that it will have other uses for the telecommunications equipment in the ordinary course of business.

Substation, an existing PG&E property, will be utilized by ETrans for materials storage. In order to prepare Vaca-Dixon Substation for use by ETrans, approximately $55,000 is needed to perform site grading and preparation to eliminate ponding in the storage area, to provide electrical service to the yard area, and to install safety barriers (removable bollards). This work must be completed before further construction can be performed at the site, in order to meet environmental and safety concerns, and to prepare the site for construction related to preparation of the site for the storage of materials and equipment. Even if Plan implementation does not occur, this work should be beneficial to PG&E in preparing the Vaca-Dixon Substation for additional storage uses by PG&E.

D. ETrans Billing Software (Cost Estimate: $360,000).[8]

In connection with the implementation of the Plan, PG&E and ETrans will enter into an Electric Energy Determination and Billing Agreement ("EEDBA") to handle billing and settlements for electric transmission service to be provided by ETrans to PG&E. PG&E has recently identified a need for specialized software to support the implementation of the EEDBA. This software will be purchased from, and installed and configured by, Itron, Inc., an industry leader in providing automated meter polling and data management software to utilities. This software will provide the functionality necessary for ETrans to provide meter data management (including data validation, version control management and data aggregation) to PG&E. These functions are needed to support the transmission billing and settlement processes required by PG&E and ETrans. PG&E believes that this project must start promptly as the process of installing, configuring and testing the software is expected to take approximately three months and must be completed in advance of the Plan Effective Date in order for ETrans to commence business operations.

PG&E estimates that the license, configuration and installation of this software by Itron will cost approximately $360,000. $150,000 of the foregoing amount constitutes a

[8] See Declaration of Lance Maeda filed concurrently herewith.

license fee that would be paid up front, while the remainder is based on estimated consulting fees related to the installation and configuration of the software as well as maintenance fees. The consulting fees and maintenance fees are subject to termination if necessary, without penalty, pursuant to the general contract provisions summarized in footnote 3 of this Motion.

E. **<u>Additional RMD Expenses (Cost Estimate: $115,000)</u>**.[9]

On May 24, 2002, PG&E filed its Motion for Authorization to Incur Data Management Expenses, which was approved by Order entered on June 20, 2002. One portion of this Motion concerned data management services related to existing records, maps and drawings ("RMD") that will be needed by the New Entities, such as engineering and construction records, customer records, facility maps and drawings, and financial records. PG&E explained that it required the services of ZIA Information Analysis Group, Inc. ("ZIA") in order to identify and compile the anticipated millions of RMD documents, and to develop and maintain a database with the RMD data. Total costs of approximately $436,000 were approved for this project.

ZIA and PG&E have been engaged in the RMD work for many months and it is now evident that the work will require more time than previously estimated. The work is more complex and time-consuming than PG&E or ZIA originally anticipated, particularly due to the tasks of determining the type and level of information required by the New Entities as well as the review of the various RMD documents for accuracy and completeness. PG&E estimates that it will incur approximately $115,000 more than the amount originally authorized so that ZIA can complete this project.[10]

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[9] <u>See</u> Declaration of Stephanie Maggard filed concurrently herewith.

[10] In addition to ZIA's work on this project, an individual consultant who is a former PG&E employee, Fred Holmes, is assisting PG&E and ZIA in reviewing and analyzing RMD documents. Based on his past experience working for PG&E, Mr. Holmes is knowledgeable about RMD documents and approximately $15,000 of the additional $115,000 may be incurred in connection with Mr. Holmes' services.

F. **Additional HRMS Expenses (Cost Estimate: $425,000).**[11]

PG&E previously filed a Motion for Authorization to Incur Human Resources Management System Expenses ("HRMS Motion") on May 10, 2002, which was approved by Order entered on May 31, 2002. In the HRMS Motion, PG&E explained that the New Entities would require human resources and payroll systems to support the payroll and related functions needed for a company employing thousands of employees with benefits comparable to PG&E's existing benefits, and the restrictions of collective bargaining agreements among other complexities. Further, PG&E explained that the New Entities would use an integrated human resources system to be implemented by PeopleSoft, Inc. and referred to as the Human Resources Management System ("HRMS"). PG&E anticipated at that time that approximately $2.2 million would be required for the HRMS implementation in connection with PeopleSoft's services.

Since May 2002, PeopleSoft has been working on the HRMS project. As explained in more detail below, the HRMS project has proven more complex and time-consuming than either PeopleSoft or PG&E had anticipated at its inception in May 2002. PG&E now estimates that an additional $425,000 will be required for the HRMS project.

The reasons for the increased costs on this project include: (i) more HRMS software customization is required than originally anticipated as a result of a more complete understanding of the factors used to implement collective bargaining agreements relating to compensation of union employees, as well as a more complete understanding of the New Entities' business requirements; (ii) more work is involved than originally anticipated in building internal and external interfaces between HRMS and other systems or organizations (internal interfaces include links to the general ledger and to the group handling workers' compensation matters; external interfaces include links to benefits providers, 401(k) financial managers and payroll tax service providers); (iii) more work is required than originally anticipated in connection with adapting the HRMS to handle data conversion and

[11] See Declaration of Bruce Bowen filed concurrently herewith.

benefits enrollment activities over a period of time; instead of using a traditional cutover plan (converting all data at one time), PG&E requires a complex set of data conversion activities to permit identification and conversion of non-bargaining unit and bargaining-unit employee data and to convert payroll and benefits data at different times; and (iv) PG&E has not been able to devote as many internal resources to this project as originally anticipated, which has increased PeopleSoft's time spent on the project.

II.
THE ADDITIONAL IMPLEMENTATION EXPENSES SHOULD BE APPROVED PURSUANT TO SECTION 363(B)(1) OF THE BANKRUPTCY CODE

PG&E seeks approval for the various implementation expenses set forth above as a use of estate property that is outside of the ordinary course of business under Bankruptcy Code Section 363(b)(1). Since these projects are related to the implementation of the Plan, PG&E believes that the purpose and scope of the expenditure may be characterized as outside of the ordinary course of business and therefore requires Court approval.[12]

The Court has considerable discretion in approving a request pursuant to Section 363(b)(1) of the Bankruptcy Code ("[t]he trustee, after notice and a hearing, may use, sell or lease, other than in the ordinary course of business, property of the estate"). See In re Montgomery Ward Holding Corp., 242 B.R. 147, 153 (D. Del. 1999) (affirming the bankruptcy court's decision to approve expenditure for employee incentive programs, noting that bankruptcy court has considerable discretion in approving a Section 363(b) motion).

In determining whether to authorize a transaction under Section 363(b)(1), courts require a debtor to show that a sound business purpose justifies such actions, applying the business judgment test. See, e.g., Stephens Indus., Inc. v. McClung, 789 F.2d 386, 389-90 (6th Cir. 1986); Committee of Equity Sec. Holders v. Lionel Corp. (In re Lionel Corp.), 722

[12] PG&E believes that the various consultants described in this Motion should not be considered "professional persons" requiring approval under Bankruptcy Code Section 327(a). This is due both to the nature of the services to be provided and to the consultants' limited role in connection with PG&E's reorganization proceeding.

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F.2d 1063, 1071 (2d Cir. 1983); see also 3 Lawrence P. King, Collier on Bankruptcy ¶363.02[1][g] (15th ed. rev. 1998).

Once the debtor has articulated a rational business justification, a presumption attaches that the decision was made "on an informed basis, in good faith and in the honest belief that the action taken was in the best interest of the [debtor]." See, e.g., Official Comm. of Subordinated Bondholders v. Integrated Res., Inc. (In re Integrated Res., Inc.), 147 B.R. 650, 656 (S.D.N.Y. 1992) (citing Smith v. Van Gorkom, 488 A.2d 858 (Del. 1985)).

Sound business justifications exist for approval of the various implementation costs described above. PG&E does not have sufficient capacity or skills in-house to perform and complete the work without the assistance of the outside consultants. Also, PG&E is solvent and has sufficient cash to pay the expenses described herein without causing any detriment to its creditors.[13]

Consistent with PG&E's previous implementation expense requests, PG&E has included only those projects that have been identified as critical for completion by or in advance of the Plan Effective Date, and which require long lead time or must be completed before subsequent, related implementation work can be performed. Furthermore, PG&E continues to enter into contracts with consultants that allow PG&E to terminate without cause and without any penalty, so that in the event that the implementation work is no longer necessary, PG&E can minimize its costs. PG&E believes that the implementation projects described herein are necessary and should be approved so that work can commence promptly. As to all previously-approved projects for which PG&E is requesting increased expenses, based on the explanations set forth in Sections I.A. through I.F. above, sound business justifications support each request to increase costs.

[13] As reflected in PG&E's November 2002 Monthly Operating Report, PG&E held more than $4.1 billion in cash reserves as of November 30, 2002.

CONCLUSION

For all of the foregoing reasons, PG&E respectfully requests that the Court approve the costs described above and grant such other and further relief as may be just and appropriate.

DATED: February 7, 2003

Respectfully,

HOWARD, RICE, NEMEROVSKI, CANADY, FALK & RABKIN
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By: Julie Landau
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PACIFIC GAS AND ELECTRIC COMPANY

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