

50-275/323

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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.

Case No. 01-30923 DM
Chapter 11 Case
[No Hearing Scheduled]

Federal I.D. No. 94-0742640

HOWARD
RICE
NEMEROVSKI
CANADY
FALK
& RABKIN
A Professional Corporation

EX PARTE APPLICATION FOR ORDER AUTHORIZING COMPROMISE OF CLAIMS
OF CALIFORNIA DEPARTMENT OF TOXIC SUBSTANCES CONTROL AND
MEMORANDUM OF POINTS AND AUTHORITIES IN SUPPORT THEREOF

[DECLARATION OF JAMES BECKER IN SUPPORT OF
APPLICATION FILED SEPARATELY]

Appl Add: Kids Eye Mail Center

1 Application, PG&E seeks authorization to enter into and be bound by, and make payments
2 under, that certain Consent Order with the DTSC, a copy of which is attached as Exhibit A
3 to the Declaration of James Becker filed concurrently herewith (the "Becker Decl."). The
4 Consent Order would require PG&E to pay \$193,715 in penalties and costs within thirty (30)
5 days after the Court's approval of this Application, and such timely payment is a material
6 term and condition of the proposed settlement.

8 FACTUAL BACKGROUND

9 A. Alleged Violations.

10 PG&E owns and operates the Diablo Canyon Power Plant located in Avila Beach,
11 California (the "Plant"). As part of its operations of the Plant, PG&E generates, handles,
12 treats and stores hazardous waste. Becker Decl. ¶3. On April 16, 2001, the DTSC
13 conducted a physical inspection of the Plant. On or about this time, DTSC also conducted a
14 review of the Plant's records relating to financial assurance. Thereafter, the DTSC notified
15 PG&E that it was in violation of Section 25202(a) of the California Health and Safety Code,
16 and various regulations promulgated thereunder, with respect to certain financial assurance
17 and operating issues. Such alleged violations include (i) the failure to establish and maintain
18 financial assurance for the closure of the Plant and for sudden accidental occurrences, and
19 the failure of PG&E to provide notices with respect to the same; (ii) the improper treatment
20 of certain hazardous wastewater; (iii) the failure to keep adequate operating records relating
21 to the location, shipment, treatment and storage of hazardous waste; (iv) the failure to
22 properly maintain and inspect portions of the secondary containment system; (v) the failure
23 to provide adequate aisle space in certain areas of the Plant; and (vi) the failure to keep
24 containers of hazardous wastes closed. Id. ¶4. While some of the alleged violations would
25 have occurred prior to the petition date in this case, other violations would have continued or
26 occurred after such date. The DTSC claims that some of the alleged violations had been in
27 effect since January of 2001 and had continued into November of 2001. PG&E disputes the
28 existence of the violations. Id. ¶5.

1 B. Consent Order.

2 Subject to the approval of this Court, PG&E and the DTSC have agreed to a tentative
3 settlement of DTSC's claims as described in detail in the Consent Order. Under the
4 settlement, PG&E would agree to pay \$193,715 in penalties and costs and would agree to a
5 schedule for complying with various regulatory provisions. The Consent Order would
6 constitute full settlement of the alleged violations. Becker Decl. ¶6.

7 C. The Consent Order Is In The Best Interest Of The Estate.

8 The DTSC claims that PG&E's actions or failures to act violate Section 25202(a) of the
9 California Health and Safety Code and various regulations promulgated thereunder as well
10 as PG&E's Hazardous Waste Facilities Permit and its Operating Plan for the site.
11 Section 25187 of the California Health and Safety Code provides for the imposition of
12 administrative penalties for such violations. In some cases, a penalty may be imposed for
13 each day that the violation exists. California Code of Regulations, Title 22, §66272.64. In
14 initial discussions between the parties, the DTSC sought substantially more penalties than
15 that provided for in the Consent Order. The DTSC also stated verbally that it believed it was
16 entitled to recover significantly more than the amount requested in such initial discussions.
17 Id. ¶7. While PG&E would vigorously contest the imposition and amount of penalties
18 sought by the DTSC, the ultimate outcome of an administrative proceeding or civil action
19 regarding this issue is uncertain and, furthermore, PG&E would have to incur substantial
20 litigation costs in defending or challenging the matter. A lawsuit would also consume
21 management resources, diverting those persons from other business of PG&E.

22 For these and other reasons, PG&E believes that the settlement of the DTSC claims in
23 accordance with the Consent Order is in the best interests of PG&E and its estate.

24
25 **ARGUMENT**

26 A. The Court Should Approve The Settlement.

27 Bankruptcy Rule 9019(a) empowers a bankruptcy court to approve any settlement or
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1 compromise related to a reorganization or liquidation.¹ Myers v. Martin (In re Martin), 91
2 F.3d 389, 393 (3d Cir. 1996); Vaughn v. Drexel Burnham Lambert Group, Inc. (In re Drexel
3 Burnham Lambert Group, Inc.), 134 B.R. 499, 505 (Bankr. S.D.N.Y. 1991). Indeed,
4 compromises and settlements are a common and favored occurrence in bankruptcy cases
5 because they allow a debtor and its creditors to avoid the financial and other burdens
6 associated with litigation over contentious issues and expedite the administration of the
7 bankruptcy estate. Protective Comm. for Indep. Stockholders of TMT Trailer Ferry, Inc. v.
8 Anderson, 390 U.S. 414, 424, reh'g denied, 391 U.S. 909 (1968); Martin v. Kane (In re A &
9 C Props.), 784 F.2d 1377, 1380-81 (9th Cir. 1986).

10 In reviewing a proposed settlement, the bankruptcy court's inquiry focuses only upon
11 whether the compromise is fair and equitable and in the best interest of the estate. TMT
12 Trailer, 390 U.S. at 424; A & C Props., 784 F.2d at 1380-81; Nellis v. Shugrue, 165 B.R.
13 115, 121 (S.D.N.Y. 1994). In making this determination, however, the bankruptcy court is
14 not required to conduct a mini-trial on the merits of the underlying dispute or an independent
15 investigation into the reasonableness of the settlement. Port O'Call Inv. Co. v. Blair (In re
16 Blair), 538 F.2d 849, 851 (9th Cir. 1976); see also In re Purofied Down Prods. Corp., 150
17 B.R. 519, 522 (S.D.N.Y. 1993); Drexel Burnham, 134 B.R. at 505.

18 Rather, the standards for such approval have been described as lenient and intended to
19 encourage approval of settlements in bankruptcy cases. See Purofied Down, 150 B.R. at
20 522-23. The bankruptcy court need only canvass the legal and factual issues underpinning
21 the compromise to ensure that the proposed settlement does not fall "below the lowest point
22 in the range of reasonableness." Nellis, 165 B.R. at 121-22 (quoting In re W.T. Grant Co.,
23 699 F.2d 599, 608 (2d Cir. 1983)); Purofied Down, 150 B.R. at 522-23; Official Unsecured
24 Creditors' Comm. of Pennsylvania Truck Lines, Inc. v. Pennsylvania Truck Lines, Inc. (In re
25 Pennsylvania Truck Lines, Inc.), 150 B.R. 595, 598 (E.D. Pa. 1992), aff'd mem., 8 F.3d 812

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27 ¹Bankruptcy Rule 9019(a) simply states, in part, that "[o]n motion by the trustee and
28 after notice and a hearing, the court may approve a compromise or settlement." Fed. R.
Bankr. P. 9019(a).

1 (3d Cir. 1993); Drexel Burnham, 134 B.R. at 505. In making this determination, significant
2 deference may be given to the informed judgment of the debtor in possession and its counsel
3 that a proposed compromise is fair and equitable. Martin, 91 F.3d at 395; Nellis, 165 B.R. at
4 122; Purofied Down, 150 B.R. at 522-23; Drexel Burnham, 134 B.R. at 505.

5 Over the years, four significant criteria have been developed by the courts for
6 consideration in determining whether a proposed settlement falls below the lowest point in
7 the range of reasonableness: (1) the probability of success on the merits; (2) the difficulties,
8 if any, to be encountered in the matter of collection; (3) the complexity of the litigation
9 involved, and the expense, inconvenience and delay necessarily attending it; and (4) the
10 paramount interest of the creditors and a proper deference to their reasonable views. A & C
11 Props., 784 F.2d at 1381; see also Martin, 91 F.3d at 393; Nellis, 165 B.R. at 122;
12 Pennsylvania Truck Lines, 150 B.R. at 598. As demonstrated below, each of the applicable
13 criteria is satisfied here.²

14 1. The Probability Of Success On The Merits.

15 The Consent Order fully and finally resolves a significant dispute between the Debtor
16 and DTSC without the need for expensive, distracting and time-consuming administrative
17 proceedings or litigation. Although PG&E disputes the DTSC's claims, in the event that any
18 such proceedings were brought, there is no certainty that PG&E would prevail and avoid the
19 imposition of penalties. Furthermore, there is no guarantee that PG&E could avoid the
20 imposition of penalties in excess of the amounts it would be required to pay under the
21 Consent Order.

22 2. The Complexity Of The Litigation, And The Expense, Inconvenience And
23 Delay Attending It.

24 The Consent Order resolves a legal dispute involving numerous claims and
25 complicated factual and legal issues. Accordingly, in agreeing to the Consent Order, the
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27 ²The second factor typically considered by courts—difficulty associated with
28 collection—is not applicable here.

1 Debtor has made what it believes is an economically prudent business judgment that the
2 estate's assets are better utilized in facilitating a settlement rather than defending an action
3 brought by the DTSC and prosecuting or defending an appeal of such an action

4 3. The Settlement Is In The Best Interest Of The Creditors.

5 The last criteria considered by bankruptcy courts reviewing a proposed settlement is
6 the paramount interest of creditors, with a deference to their reasonable views. A & C
7 Props., 784 F.2d at 1381; Drexel Burnham, 134 B.R. at 505-06. While a creditor's objection
8 to a proposed settlement must be considered, it is not controlling and will not bar approval of
9 settlements that "do[] not fall below the lowest point in the range of reasonableness." A & C
10 Props., 784 F.2d at 1382; Drexel Burnham, 134 B.R. at 505.

11 The compromise reached in the Consent Order benefit not only the estate but all
12 creditors. The Consent Order constitutes a settlement in full of the alleged violations, which
13 will preserve estate assets by avoiding further litigation costs and fines which potentially
14 could exceed the amounts payable under the settlement.

15 B. The Court Should Allow Payment Of Funds Prior To Plan Confirmation
16 Notwithstanding That Some of DTSC's Claims May Be Pre-Petition Claims.

17 As discussed above, the DTSC's claims involve both pre-petition and post-petition
18 conduct, and the Consent Order requires the payment of fines promptly following receipt of
19 an order approving this Application. Thus, it can be argued that, to some degree, this
20 Application seeks authority to pay pre-petition claims prior to the confirmation and
21 implementation of a plan of reorganization in this case. Under the circumstances, however,
22 PG&E believes it is appropriate for the Court to authorize a settlement in this instance.

23 First, the DTSC would not agree to the settlement unless PG&E would agree to pay the
24 fines in a timely manner (i.e., within thirty (30) days) following the Bankruptcy Court's
25 approval of the Consent Order. Without a settlement, the DTSC would likely file a civil
26 action against PG&E in the California Superior Court, which would subject PG&E to risk of
27 a judgment that is materially worse than the proposed settlement provided for in the Consent
28 Order. In addition, PG&E would be required to expend substantial monies in defending

1 such a lawsuit. While PG&E could argue that any such action by the DTSC would be in
2 violation of the automatic stay (11 U.S.C. §362(a)), the DTSC would likely take the position
3 that the action was exempt from the automatic stay pursuant to Section 362(b)(4) because it
4 is pursuant to a governmental unit's police or regulatory power. (11 U.S.C. §362(b)(4)).

5 Second, if the Consent Order were not approved and DTSC filed a civil action against
6 PG&E, DTSC would argue that, even if it were prevented from imposing and collecting
7 penalties for pre-petition violations, many of the alleged violations involve post-petition
8 violations and that the stay would not apply to prevent DTSC from imposing and collection
9 penalties for such violations. These post-petition penalties could be as much or more than
10 the penalties imposed under the Consent Order.³ Thus, although PG&E could argue that the
11 claims based on pre-petition conduct are stayed and/or not subject to enforcement,⁴ it is
12 likely that PG&E would still have to defend and possibly pay penalties (prior to the
13 confirmation of a plan) with respect to claims based on post-petition conduct.

14 In short, absent a prompt payment of penalties by PG&E in accordance with the
15 Consent Order, the DTSC would not agree to a settlement of its claims. Without a
16 settlement, it is likely that PG&E would be engaged in an extended and expensive litigation,
17 the ultimate result of which could be significantly worse for PG&E than the settlement
18 proposed in the Consent Order. Also, to the extent that the DTSC succeeds in proving post-
19 petition violations, PG&E could be forced to pay penalties to DTSC prior to the
20 confirmation of a plan of reorganization in this case. Thus, PG&E believes that it is in the
21 best interest of the estate to agree to the Consent Order and to pay the amounts provided
22 under the Consent Order.

23 Finally, PG&E notes that both of the competing reorganization plans proposed in this
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25 ³The imposition of administrative penalties is subject to many subjective factors that
26 are more art than science. See California Health & Safety Code, §25187; California Code of
Regulations, Title 22, §66272.60 et seq.

27 ⁴Even if the DTSC could bring an action against PG&E for pre-petition conduct under
28 Section 362(b)(4), PG&E would argue that it could not enforce an monetary judgment
obtained in such action under such section.

1 case provide for the payment in full of all pre-petition claims. Therefore, the early payment
2 of the DTSC claim by virtue of the payment of the penalties would not have a material effect
3 on other creditors or the estate.

4 C. Payment Of Potential Pre-Petition Claims Pursuant To Consent Judgment Should
5 Be Authorized Pursuant To Section 105 Of The Bankruptcy Code And The
6 Court's Inherent Equitable Powers.

7 As discussed above, the proposed settlement may be deemed to involve the payment of
8 a pre-petition claim prior to the implementation of a confirmed plan of reorganization in this
9 case. To the extent that Bankruptcy Rule 9109(a) would not authorize such a payment,
10 Section 105(a) of the Bankruptcy Code may be relied on for such authority. Section 105(a)
11 authorizes a bankruptcy court to "issue any order, process, or judgment that is necessary or
12 appropriate to carry out the provisions of this title." The purpose of Section 105 is "to assure
13 the bankruptcy courts' power to take whatever action is appropriate or necessary in aide of
14 the exercise of their jurisdiction." 2 Lawrence P. King, Collier on Bankruptcy ¶105.01 at
15 105-6 (15th ed. rev. 2000). For the reason stated above, the proposed settlement embodied
16 in the Consent Order, including the prompt funding of \$193,715 in penalties, is in the best
17 interests of the Debtor and its estate. Accordingly, if for any reason this Court determines
18 that the prompt funding of the \$193,715 by PG&E called for pursuant to the Consent
19 Judgment is not authorized pursuant to Bankruptcy Rule 9109(a), PG&E requests that the
20 Court authorize such payment pursuant to the Court's authority and discretion under Section
21 105(a) of the Bankruptcy Code.
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CONCLUSION

The Debtor has carefully considered the risks, complexity and expense associated with further litigation of the disputes between it and the DTSC. In the Debtor's sound business judgment, these factors tip the scale heavily in favor of approval of the proposed Consent Order as fair, reasonable and equitable and in the best interests of the estate and its constituencies. For these reasons, the Debtor respectfully requests that the Court grant this Application and approve the Consent Order in the form attached as Exhibit A to the Becker Declaration.

DATED: _____, 2003.

Respectfully,

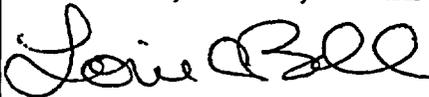
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By: _____
JEFFREY L. SCHAFFER

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PACIFIC GAS AND ELECTRIC COMPANY

THE OFFICIAL COMMITTEE OF UNSECURED CREDITORS HAS NO OBJECTION TO THE FOREGOING APPLICATION AND THE RELIEF REQUESTED THEREIN.

MILBANK, TWEED, HADLEY & McCLOY LLP



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