IN THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

No. 02-72735

PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA,

AND

COUNTY OF SAN LUIS OBISPO

Petitioners-Appellants,

v.

U.S. NUCLEAR REGULATORY COMMISSION,

Defendants-Appellees,

PACIFIC GAS AND ELECTRIC COMPANY, et al.

Intervenors

PETITONERS' EXCERPTS OF RECORD
VOLUME I OF III

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Dated: December 5, 2002

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CHRONOLOGICAL INDEX

VOLUME III (continued)

PUBLIC VERSION
(ONLY VOLUME V CONTAINS
PRIVILEGED INFORMATION)

UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

Pacific Gas and Electric Company	)	
PG&E Corporation	)	Docket Nos. EC02-___-000,
On Behalf of Its Subsidiaries	)	EL02-___-000 and
Electric Generation LLC,	)	CP02-___-000
ETrans LLC and GTrans LLC	)	

APPLICATION
SEEKING APPROVAL UNDER SECTION 203 OF THE FEDERAL POWER ACT AND RELATED DECLARATORY ORDERS UNDER SECTIONS 201 AND 305 OF THE FEDERAL POWER ACT AND SECTION 12 OF THE NATURAL GAS ACT

VOLUME I

APPLICATION
ATTACHMENTS 1 THROUGH 3
REQUIRED EXHIBITS A THROUGH H

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November 30, 2001

approximately 50% beginning with the end of the eleventh year of the 12-year term). This is consistent with Commission policy; the Commission has encouraged "the [California] IOUs to move their load to long-term contracts of two years or more." *See December 15 Order*, 93 FERC at 61,993. The Power Sales Agreement will thus be one component of PG&E's portfolio so as to avoid return to the pre-December 15 structure of excessively heavy reliance on spot market purchases. The Power Sales Agreement will also assure continued access by Reorganized PG&E to ancillary services sufficient to support the load requirements of its control area. Thus, the Plan contributes to resolution of the problems that the *December 15 Order* sought to alleviate.[55]

V. REQUEST FOR AUTHORIZATION TO TRANSFER NUCLEAR DECOMMISSIONING FUNDS

As part of the Transaction, PG&E will transfer to Diablo Canyon LLC ownership of DCPP and all assets related thereto. Accordingly, Applicants are seeking Commission authorization for PG&E to assign 100% of the beneficial interest in the portions of PG&E's Nuclear Decommissioning Trusts associated with DCPP to Diablo Canyon LLC. The assignment by PG&E of its beneficial interest in these portions of its Nuclear Decommissioning Trusts to Diablo Canyon LLC is an essential element of the

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[55] PG&E respectfully requests relief from the Commission's *December 15 Order* to the extent that the Order returned rate regulation of the output of PG&E's generation facilities to the CPUC. FERC ruled that as of December 15, 2000, "25,000 MW of generation owned by or under contract to the IOUs, . . . may be sold directly at retail by the IOUs subject to the regulation of California. The State is free as of the date of issuance of this order to regulate this power on a cost-of-service basis, subject to a cost cap, or in any way it sees fit." *Id.* at 61,982. The FERC identified this "market reform" as a "remedial measure" required to address the specific problem of state-mandated sales to the PX, which was aggravating the high cost of power in the market. *Id.* The market structure permitted other companies to bid up the price of power available from PG&E's owned generation, and profit by reselling it to PG&E, rather than permitting PG&E to secure long-term access to such output. That situation, with the termination of PX operations, is now moot so this requirement is no longer relevant.

Transaction as the NRC requires Diablo Canyon LLC to have adequate assurance of decommissioning funding.

PG&E maintains external Nuclear Decommissioning Trusts as authorized by 10 C.F.R. § 50.75(e)(1)(ii) in order to provide the NRC with the required decommissioning funding assurance for its nuclear generating plants. The Trusts include money associated with both DCPP Unit 1 and DCPP Unit 2.[56] Because PG&E is subject to regulation by both the CPUC and FERC, the Trusts, as they pertain to DCPP, consist of both CPUC jurisdictional and FERC jurisdictional trusts.

Concurrently with this Application, Applicants are filing an application with the NRC, pursuant to Section 184 of the Atomic Energy Act of 1954 ("AEA"), 42 U.S.C. § 2234 and 10 C.F.R. § 50.80, to transfer the operating licenses for DCPP Units 1 and 2 to Diablo Canyon LLC and to Gen ("NRC Application"). Diablo Canyon LLC would be licensed to own (possess) DCPP Units 1 and 2 and Gen would be licensed to possess, use and operate the units. Gen will lease DCPP from Diablo Canyon LLC and operate DCPP. As part of its review of the NRC Application, the NRC will evaluate the technical and financial qualifications of Diablo Canyon LLC and Gen, including the sufficiency of the Trusts to meet the eventual decommissioning costs for DCPP.

To the extent the Commission may deem the transfer of such beneficial interest to be jurisdictional, Applicants are seeking Commission approval under Section 203 to assign PG&E's beneficial interests in the portions of the Trusts that are associated

[56] The Trusts also include money associated with Humboldt Bay Unit 3. PG&E will retain its beneficial interests in the Trusts associated with Humboldt Bay for the purpose of decommissioning Humboldt Bay. All of the funds in the Trusts associated with Humboldt Bay will be segregated from the DCPP components of the Trusts as part of the Transaction.

with both DCPP Unit 1 and Unit 2 to Diablo Canyon LLC.[57] Assignment of PG&E's beneficial interests in the portions of the Trusts associated with DCPP is an essential element of the Transaction because it is necessary to permit Diablo Canyon LLC to become the owner of DCPP under the AEA and the NRC's implementing regulations, is consistent with the public interest and is in the public interest. *See Niagara Mohawk Power Corp.*, 89 FERC ¶ 61,124 at 61,347-48 (1999); *see also Baltimore Gas & Elec. Co.*, 90 FERC ¶ 62,222, *reh'g denied*, 92 FERC ¶ 61,043 (2000) (Commission found that the entirety of a proposed intra-corporate asset transfer, including the transfer of a decommissioning trust fund, was consistent with the public interest and authorized the proposed transaction under Section 203). (Diablo Canyon LLC will be obligated to return to PG&E for refund to its customers any decommissioning funds unexpended when the decommissioning of Diablo Canyon is complete.) As discussed above, the proposed Transaction as a whole, including the transfer of the Trusts, is in the public interest. Accordingly, the Commission should authorize PG&E to assign 100% of its beneficial interests in the Trusts associated with DCPP Units 1 and 2 to Diablo Canyon LLC as part of its authorization for the Transaction.

VI. REQUEST FOR CONFIRMATION THAT THE PLAN DOES NOT VIOLATE SECTION 305(a) OF THE FPA OR SECTION 12 OF THE NGA

A. Statutory Standard

Applicants seek affirmation that the declaration and payment of certain dividends does not constitute the making or paying of dividends from funds properly

[57] In connection with the confirmation of its Plan, PG&E will also seek an order of the Bankruptcy Court pursuant to Section 1142(b) of the Bankruptcy Code (11 U.S.C. § 1142(b)) compelling the CPUC to approve the transfer of the beneficial interests of the CPUC jurisdictional trusts associated with DCPP to Diablo Canyon LLC, or, in the alternative, deeming such approval to have been granted by the CPUC.

Consent Decree may also be obtained by mail from the Consent Decree Library, PO Box 7611, U.S. Department of Justice, Washington, DC 20044–7611. In requesting a copy, please refer to *United States* v. *Texaco Exploration and Production Inc. and Envirotech Inc.*, Case No. 2:01 CV–1050 ST (D. Utah), DOJ Ref. 90–5–2–1–06466, and enclose a check in the amount of $6.75 (25 cents per page reproduction cost) payable to the Consent Decree Library.

Ellen M. Mahan,

Assistant Section Chief, Environmental Enforcement Section, Environment and Natural Resources Division.

[FR Doc. 02–01176 Filed 1–16–02; 8:45 am]

BILLING CODE 4410–15–M

DEPARTMENT OF JUSTICE

Notice of Lodging of Consent Decree Under the Clean Air Act and the Emergency Planning and Community Right-To-Know Act

In accordance with Departmental policy, 28 CFR 50.7, notice is hereby given that on December 28, 2001, a proposed consent decree in *United States v. Texaco Exploration and Production Inc. and Envirotech Inc.*, Case No. 2:01 CV–1050 ST, was lodged with the United States District Court for the District of Utah.

This consent decree represents a settlement of claims brought against Texaco Exploration and Production Inc. ("Texaco") and Envirotech Inc. under section 113(b) of the Clean Air Act ("the CAA"), 42 U.S.C. 7413(b), and section 325(b)(3) of the Emergency Planning and Community Right-to-Know Act ("EPCRA"), 42 U.S.C. 11045(b)(3), in a civil complaint filed concurrently with the lodging of the consent decree. The complaint alleges that Texaco violated the CAA and the New Source Performance Standards, 40 CFR part 60, subparts A and KKK, at its Aneth gas plant by failing to monitor its equipment for VOC leaks, maintain records, submit reports, test its flare, and use a thermocouple to monitor its flare's pilot flame. The complaint also alleges that Texaco and Envirotect violated the CAA and the National Emission Standards for Hazardous Air Pollutants for asbestos, 40 CFR part 61, subpart M, during the removal and disposal of asbestos-containing material at the Aneth gas plant. Finally, the complaint alleges that Texaco violated section 304 of EPCRA, 42 U.S.C. 11004, by twice failing to report the release of more than 500 pounds of sulfur dioxide from its oil and gas production field in Aneth, Utah.

Under the proposed settlement, Texaco will submit a certification that its affected facility is now in compliance with the monitoring, recordkeeping, and reporting requirements of 40 CFR part 60, subpart KKK. In addition, Texaco will pay a civil penalty of $243,725 and provide up to $51,275 in emergency response equipment and hazardous materials training to a local fire department in Montezuma Creek, Utah, as a supplemental environmental project. Envirotech will pay a civil penalty of $10,000.

The Department of Justice will receive comments relating to the proposed consent decree for a period of thirty (30) days from the date of this publication. As a result of the discovery of anthrax contamination at the District of Columbia mail processing center in mid-October, 2001, the delivery of regular first-class mail sent through the U.S. Postal Service has been disrupted. Consequently, public comments that are addressed to the Department of Justice in Washington, DC and sent by regular, first-class mail through the U.S. Postal Service are not expected to be received in a timely manner. Therefore, comments should be addressed to the Assistant Attorney General, Environment and Natural Resources Division, U.S. Department of Justice, and sent: (1) C/o Robert D. Mullaney, U.S. Department of Justice, 301 Howard St., Suite 1050, San Francisco, CA 94105; and/or (2) by facsimile to (202) 353–0296; and/or (3) by overnight delivery, other than through the U.S. Postal Service, to Chief, Environmental Enforcement Section, 1425 New York Avenue, NW., 13th Floor, Washington, DC 20005. Each communication should refer on its face to *United States* v. *Texaco Exploration and Production Inc. and Envirotech Inc.*, DOJ Ref. 90–5–2–1–06466.

The proposed consent decree may be examined at the Office of the United States Attorney, 185 South State Street, Suite 400, Salt Lake City, Utah 84111, and at the Region IX Office of the Environmental Protection Agency, 75 Hawthorne Street, San Francisco, CA 94105. A copy of the proposed Consent Decree may also be obtained by faxing a request to Tonia Fleetwood, Department of Justice Consent Decree Library, fax no. (202) 616–6584; phone confirmation no. (202) 514–1547. There is a charge for the copy (25 cent per page reproduction cost). Upon requesting a copy, please mail a check payable to the "U.S. Treasury," in the amount of $6.75 to: Consent Decree Library, U.S. Department of Justice, P.O. Box 7611, Washington, DC 20044–7611. The check should refer to *United States* v. *Texaco Exploration and Production Inc. and Envirotech Inc.*, DOJ Ref. 90–5–2–1–06466.

Ellen M. Mahan,

Assistant Section Chief, Environmental Enforcement Section, Environment and Natural Resources Division.

[FR Doc. 02–1177 Filed 1–16–02; 8:45 am]

BILLING CODE 4410–15–M

NUCLEAR REGULATORY COMMISSION

[Docket Nos. 50–275 and 50–323]

Pacific Gas and Electric Company, Diablo Canyon Nuclear Power Plant, Unit Nos. 1 and 2; Notice of Consideration of Approval of Transfer of Facility Operating Licenses and Conforming Amendments and Opportunity for a Hearing

The U.S. Nuclear Regulatory Commission (the Commission) is considering the issuance of an order under 10 CFR 50.80 approving the transfer of Facility Operating Licenses Nos. DPR–80 and DPR–82, for the Diablo Canyon Nuclear Power Plant, Unit Nos. 1 and 2 (Diablo Canyon) currently held by Pacific Gas and Electric Company (PG&E), as owner and licensed operator of Diablo Canyon. The Commission is also considering amending the licenses for administrative purposes to reflect the proposed transfer, and amending the antitrust conditions in licenses as discussed below.

According to an application for approval filed by PG&E, the transfer of the licenses would be to a new generating company named Electric Generation LLC (Gen), which would operate the facility, and to a new wholly-owned subsidiary of Gen named Diablo Canyon LLC (Nuclear), which would hold title to Diablo Canyon and lease it to Gen. PG&E is requesting approval of these transfers in connection with a comprehensive Plan of Reorganization (Plan) for PG&E filed under Chapter 11 of the United States Bankruptcy Code.

No physical changes to Diablo Canyon or operational changes are being proposed in the application.

The proposed conforming administrative amendments generally would replace references to PG&E in the licenses with references to Gen and Nuclear, as appropriate, to reflect the proposed transfer. With specific regard to the antitrust conditions in the licenses, the application proposes changes such that Gen will be inserted in the conditions and thus become

subject to complying with them, and E Trans LLC, a new company that will be affiliated with Gen upon implementation of the Plan and that will acquire the electric transmission assets of PG&E but not have any interest in Diablo Canyon, will be also be inserted in the conditions and thus become subject to complying with them. In addition, the application proposes that PG&E will remain designated in the conditions for the limited purpose of compliance with the conditions, notwithstanding the divesting of its interest in Diablo Canyon, while Nuclear will not be named in the conditions.

Notwithstanding the proposed changes to the antitrust conditions proffered as part of the amendments to conform the licenses to reflect their transfer from PG&E to Gen and Nuclear, the Commission is considering specifically whether to approve either all of the proposed changes to the conditions, or only some, but not all, of the proposed changes, as may be appropriate and consistent with the Commission's decision in Kansas Gas and Electric Co., et al. (Wolf Creek Generating Station, Unit 1), CLI-99-19, 49 NRC 441, 466 (1999). In particular, the Commission is considering approving only those changes that would accurately reflect Gen and Nuclear as the only proposed entities to operate and own Diablo Canyon.

Pursuant to 10 CFR 50.80, no license, or any right thereunder, shall be transferred, directly or indirectly, through transfer of control of the license, unless the Commission shall give its consent in writing. The Commission will approve an application for the transfer of a license if the Commission determines that the proposed transferee is qualified to hold the license, and that the transfer is otherwise consistent with applicable provisions of law, regulations, and orders issued by the Commission pursuant thereto.

Before issuance of conforming license amendments, the Commission will have made findings required by the Atomic Energy Act of 1954, as amended (the Act), and the Commission's regulations.

As provided in 10 CFR 2.1315, unless otherwise determined by the Commission with regard to a specific application, the Commission has determined that any amendment to the license of a utilization facility which does no more than conform the license to reflect the transfer action involves no significant hazards consideration. No contrary determination has been made with respect to this specific license amendment application. In light of the generic determination reflected in 10 CFR 2.1315, no public comments with respect to significant hazards considerations are being solicited, notwithstanding the general comment procedures contained in 10 CFR 50.91.

The filing of requests for hearing and petitions for leave to intervene, and written comments with regard to the license transfer application, are discussed below.

By February 6, 2002, any person whose interest may be affected by the Commission's action on the application may request a hearing and, if not the applicant, may petition for leave to intervene in a hearing proceeding on the Commission's action. Requests for a hearing and petitions for leave to intervene should be filed in accordance with the Commission's rules of practice set forth in Subpart M, "Public Notification, Availability of Documents and Records, Hearing Requests and Procedures for Hearings on License Transfer Applications," of 10 CFR Part 2. In particular, such requests and petitions must comply with the requirements set forth in 10 CFR 2.1306, and should address the considerations contained in 10 CFR 2.1308(a). Untimely requests and petitions may be denied, as provided in 10 CFR 2.1308(b), unless good cause for failure to file on time is established. In addition, an untimely request or petition should address the factors that the Commission will also consider, in reviewing untimely requests or petitions, set forth in 10 CFR 2.1308(b)(1)-(2).

Requests for a hearing and petitions for leave to intervene should be served upon Richard F. Locke, Esq., Pacific Gas and Electric Company, 77 Beale Street, B30A, San Francisco, California 94105 (e-mail address *rfl6@pge.com*), and to David A. Repka, Esq., Winston & Strawn, 1400 L Street, NW., Washington, DC 20005 (e-mail address *drepka@winston.com*); the General Counsel, U.S. Nuclear Regulatory Commission, Washington, DC 20555 (e-mail address for filings regarding license transfer cases only: *ogclt@nrc.gov*); and the Secretary of the Commission, U.S. Nuclear Regulatory Commission, Washington, DC 20555-0001, Attention: Rulemakings and Adjudications Staff, in accordance with 10 CFR 2.1313.

The Commission will issue a notice or order granting or denying a hearing request or intervention petition, designating the issues for any hearing that will be held and designating the Presiding Officer. A notice granting a hearing will be published in the Federal Register and served on the parties to the hearing.

As an alternative to requests for hearing and petitions to intervene, by February 19, 2002, persons may submit written comments regarding the license transfer application, as provided for in 10 CFR 2.1305. The Commission will consider and, if appropriate, respond to these comments, but such comments will not otherwise constitute part of the decisional record. Comments should be submitted to the Secretary, U.S. Nuclear Regulatory Commission, Washington, DC 20555-0001, Attention: Rulemakings and Adjudications Staff, and should cite the publication date and page number of this Federal Register notice.

Further details with respect to this action, see the application dated November 30, 2001, available for public inspection at the Commission's Public Document Room, located at One White Flint North, 11555 Rockville Pike (first floor), Rockville, Maryland. Publicly available records will be accessible electronically from the Agencywide Documents Access and Management Systems (ADAMS) Public Electronic Reading Room on the internet at the NRC Web site, *http://www.nrc.gov/ADAMS/index.html*. Persons who do not have access to ADAMS or who encounter problems in accessing the documents located in ADAMS, should contact the NRC Public Document Room (PDR) Reference staff by telephone at 1-800-397-4209, 301-415-4737 or by email to *pdr@nrc.gov*.

Dated at Rockville, Maryland this 10th day of January 2002.

For the Nuclear Regulatory Commission.

Girija S. Shukla,

Project Manager, Section 2, Project Directorate IV, Division of Licensing Project Management, Office of Nuclear Reactor Regulation.

[FR Doc. 02-1211 Filed 1-16-02; 8:45 am]

BILLING CODE 7590-01-P

SENTENCING COMMISSION

Sentencing Guidelines for United States Courts

AGENCY: United States Sentencing Commission.

ACTION: Notice of proposed amendments to sentencing guidelines, policy statements, and commentary. Request for public comment. Notice of public hearing.

SUMMARY: Pursuant to section 994(a), (o), and (p) of title 28, United States Code, the Commission is considering promulgating certain amendments to the sentencing guidelines, policy statements, and commentary. This notice sets forth the proposed

UNITED STATES OF AMERICA
BEFORE THE
NUCLEAR REGULATORY COMMISSION

In the Matter of Pacific Gas and Electric Company Application for License Transfers and Conforming Administrative License Amendments for Diablo Canyon Power Plant, Units 1 and 2	Docket Nos. 50-275, 50-323

PETITION OF THE CALIFORNIA PUBLIC UTILITIES COMMISSION FOR LEAVE TO INTERVENE, AND MOTION TO DISMISS APPLICATION, OR IN THE ALTERNATIVE, REQUEST FOR STAY OF PROCEEDINGS, AND REQUEST FOR SUBPART G HEARING DUE TO SPECIAL CIRCUMSTANCES

February 5, 2002

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LIST OF EXHIBITS

Exhibit F:	"Motion for Summary Disposition, or in the Alternative, Protest and Request for Consolidation and Hearing, of the Public Utilities Commission of the State of California," filed on January 29, 2002 in *Electric Generation LLC*, Federal Energy Regulatory Commission, Docket No. ER02-456-000
Exhibit G:	Declaration of David R. Effross
Exhibit H:	*Oakland Tribune*, February 1, 2002, copy of newspaper article, "New Terror Attacks on U.S. Predicted/ Nuclear reactor seen as possible target"
Exhibit I:	Diablo Canyon Independent Safety Committee, Annual Report, covering July 1, 2000 through June 30, 2001

UNITED STATES OF AMERICA
BEFORE THE
NUCLEAR REGULATORY COMMISSION

In the Matter of Pacific Gas and Electric Company Application for License Transfers and Conforming Administrative License Amendments for Diablo Canyon Power Plant, Units 1 and 2	Docket Nos. 50-275, 50-323

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Pursuant to 10 CFR §§ 2.1306, 2.1309 and 2.1329(b), the Public Utilities Commission of the State of California ("CPUC") hereby petitions for leave to intervene in the pending Application of the Pacific Gas and Electric Company ("PG&E") to transfer the operating licenses for the Diablo Canyon Power Plant ("DCPP") Units 1 and 2 to a new operating and generating company named Electric Generation LLC ("Gen") and to transfer the ownership of the DCPP units to a new, wholly owned subsidiary of Gen named Diablo Canyon LLC ("Diablo") submitted in the above-captioned dockets (the "Application"), moves to dismiss the Application, or, in the alternative, requests a stay of the proceedings, and requests the United States Nuclear Regulatory Commission ("NRC" or "Commission") to conduct a hearing on the Application.

Communications to the CPUC in this matter should be addressed to:

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In support of its Petition for Intervention, its Motion to Dismiss the Application, or, in the alternative, to stay the proceedings, and its request for a subpart G hearing due to special circumstances, and pursuant to 10 CFR § 2.1306, the CPUC identifies herein below, and in the various Exhibits hereto, the issues it seeks to raise, as well as (i) a demonstration that these issues are within the scope of the proceeding, (ii) a demonstration that these issues are relevant to the findings that the NRC must make in order to grant PG&E's requested transfer, (iii) a statement of the facts and expert opinion supporting the CPUC's position and its requests, and (iv) information showing that a genuine dispute exists with PG&E on material issues of fact and fact.

Finally, <u>if</u> and when the Commission moves forward in this matter, the CPUC also requests, pursuant to 10 C.F.R. §2.1329(b), due to the "special circumstances concerning

the subject of the hearing" that the Commission hold a substantive subpart G hearing. The CPUC contends that due to the complex nature of the legal, policy and factual issues it raises, as set forth herein below, the application of subpart M, particularly in cross examination and discovery, would not serve the purposes for which the rule was intended -- full and fair hearing on license transfer on an expedited basis. The CPUC contends that upon careful examination of the materials provided herein below and attached hereto, the Commission will have an adequate basis to determine that the matters in this license transfer are not strictly "financial in nature" as contemplated in the promulgation of Subpart M. In this regard, the Commission's ruling in *Niagara Mohawk Power Corporation, New York State Electric & Gas Corporation, and AmerGen Energy Company, LLC* (Nine Mile Points, Units 1 & 2), 50 NRC 333, 1999 NRC LEXIS 115 at *18-19 (December 22, 1999), is distinguishable from the instant case. In this case, there are fundamental legal issues at stake, as well as important considerations of public policy, national security and public health and safety, not merely administrative determinations concerning the paper transfer of a the license and conforming of technical specifications to reflect such a mere paper change.

The CPUC contends that the Commission will completely abdicate its responsibility to protect public health and safety, and thereby abdicate its duty to safeguard the national interest under the Atomic Energy Act, §§ 105, 184, 189a, if it permits the license transfer at issue to go forward as a purely ministerial determination without considering the extensive substantive issues surrounding this particular proposed license transfer. Such issues will only receive adequate attention in the context of a full

adjudicatory hearing process with the right to call for evidence, present evidence, and cross examine evidence.

In support of the above motions and requests, the CPUC sets forth as follows:

I. THE INTERESTS OF THE CPUC IN THIS MATTER AND MOTION TO DISMISS

The CPUC is a constitutionally established agency charged with the responsibility for regulating electric corporations within the State of California. In addition, the CPUC has a statutory mandate to represent the interests of electric consumers throughout California in proceedings before the Commission. The CPUC currently exercises regulatory authority over DCPP. As is set forth in detail below, these fundamental interests and responsibilities of the CPUC are directly threatened by the proposed license transfer at issue in this Application.

A. PG&E's NOVEMBER 30 FILINGS

On November 30, 2001, PG&E submitted this Application, as well as a voluminous and complex series of filings before the Federal Energy Regulatory Commission ("FERC"), (collectively, the "November 30 Filings") as part of the implementation of PG&E's proposed Plan of Reorganization under Chapter 11 of the Bankruptcy Code ("Plan"). The Plan was jointly filed by PG&E and its holding company parent, PG&E Corporation ("Parent"), with the Bankruptcy Court on September 20, 2001. PG&E's Plan involves a complex disaggregation of various businesses within PG&E and the spin-off of its distribution business to a Reorganized PG&E, which will be a separate company that will no longer be affiliated with the remainder of the disaggregated businesses. In effect, the current vertically-integrated PG&E will become a distribution company only

and its generation, electric transmission and gas storage and transmission operations will be unbundled into separate companies that remain affiliated with one another under the Parent, but unaffiliated with Reorganized PG&E. Under this Plan, only this Reorganized PG&E will be subject to CPUC regulation. Indeed, as the CPUC has recently stated in its November 27, 2001 bankruptcy filing in response to PG&E's proposed disclosure statement:

> "Through its Plan and Disclosure Statement PG&E seeks to affect a regulatory jailbreak unprecedented in scope in bankruptcy annals. Under the guise of section 1123(a)(5) of the Bankruptcy Code and through a misapplication of the debtor protection provisions of chapter 11, PG&E seeks sweeping preemptive relief primarily in the form of no fewer than fifteen affirmative declaratory and injunctive rulings, each designed to permanently dislocate various state and local laws and regulations affecting PG&E's operation of its public utility. (Fn omitted). PG&E's Plan is concerned only secondarily with adjusting debtor-creditor relations and restoring its utility operations to financial health. To be sure, if those were PG&E's primary concerns, then it would have proposed a much more straightforward reorganization strategy. PG&E has as its own agenda an escape from CPUC and State regulation.[1]"

The November 30 Filings are highly controversial. The various applications before the FERC, together with this Application before the NRC, are inextricably linked, and the November 30 Filings involve complex legal issues that will be heavily contested. The NRC and the FERC will be required to carefully scrutinize these applications, as they raise difficult legal issues in order to ultimately determine whether PG&E's filings

[1] "California Public Utilities Commission's Objection to Proposed Disclosure Statement for Plan of Reorganization Under Chapter 11 of the Bankruptcy Code for Pacific Gas and Electric Company Proposed by Pacific Gas and Electric Company and PG&E Corporation," filed November 27, 2001, *In re Pacific Gas and Electric Company*, United States Bankruptcy Court Northern District of California, San Francisco Division , Case No. 01-30923 DM, at 3. A copy of the CPUC's November 27, 2001 filing in that case is attached as Exhibit A to this pleading.

are in the public interest, and meet related statutory requirements. PG&E has not sought state-required approvals for any of its proposals, asserting that all state law is preempted by section 1123(a)(5) of the Bankruptcy Code. This assertion is being vigorously challenged by the CPUC, the State of California, and other parties before the Bankruptcy Court.

The CPUC submits that the November 30 Filings, including this Application, are premature and must be dismissed. The November 30 Filings seek to implement PG&E's Plan of Reorganization ("Plan") on file with the Bankruptcy Court. The November 30 Filings thus assume the legal validity of the Plan, and assume that the Plan will move forward. Both of these critical assumptions underlying the November 30 Filings may be, and in the CPUC's view are, incorrect. Moreover, the Bankruptcy Court is expected to issue rulings on these matters in the near future. The Bankruptcy Court's ruling on certain facial preemption issues, discussed further below, will determine whether PG&E's plan is lawful and may move forward at all. The Bankruptcy Court's ruling on whether the CPUC may file an Alternative Plan, also discussed below, will bear on, if lawful, whether and to what extent PG&E's Plan moves forward. Accordingly, PG&E's pending Application in this matter should be dismissed pending orders from the Bankruptcy Court. In the alternative, the Commission should stay all proceedings in this matter, and should defer taking any action on PG&E's Application herein until the complex legal issues being addressed in the Bankruptcy Court -- which issues directly bear on PG&E's authority even to submit this Application -- are resolved. A failure to deny this motion will necessarily result in wasteful, expensive and possible useless

proceedings, the results of which, depending on the rulings of the Bankruptcy Court, could well have to be undone.

B. THE ALTERNATIVE PLAN

On January 16, 2002, the Bankruptcy Court held a hearing on PG&E's motion to extend the period in which PG&E has an exclusive right to propose plans of reorganization beyond February 4, 2002. The CPUC, the State of California on behalf of various state agencies, and others opposed PG&E's motion. The CPUC has developed and is prepared to file in short order an Alternative Plan of Reorganization ("Alternative Plan"). Unlike the PG&E Plan, the Alternative Plan does not require disassembling the nation's largest public utility, and does not require either the Bankruptcy Court or FERC to reject the application of century-old state regulatory statutes critical to health, safety, and welfare of thirty million citizens. The Bankruptcy Court did not issue a final ruling on the motion at the January 16 hearing. Rather, the Bankruptcy Court provided the CPUC until February 13, 2002 to provide the Bankruptcy Court with a term sheet demonstrating that the CPUC's proposed Alternative Plan is feasible.[2] Upon review of the term sheet, the Bankruptcy Court will rule on whether the CPUC will be permitted to file the Alternative Plan.

A copy of the CPUC's "Objection To Pacific Gas & Electric Company's Second Motion For Order Further Extending Exclusivity Period For Filing Plan Of Reorganization To Permit The California Public Utilities Commission To File An Alternate Plan Of Reorganization" is attached hereto as Exhibit B. The following are

[2] The Bankruptcy Court extended the exclusivity period as to all parties other than the CPUC to June 30, 2002.

certain of the significant provisions of the CPUC's Alternative Plan:

- PG&E's short-term borrowings incurred during the energy crisis would be paid in full in cash (including accrued and unpaid interest through the effective date) by the first quarter of 2003 through a combination of PG&E's cash on hand (approximately $4.9 billion as of November 30, 2001 according to PG&E's most recent 8-K filing with the SEC)[3] and PG&E's residual revenues after deducting authorized revenue requirements from billed revenues ("residual revenues");

- all of PG&E's remaining indebtedness would be reinstated or refinanced;

- PG&E's creditworthiness and financial viability would be restored – the Commission would adopt a post-bankruptcy rate structure consistent with state law that would provide PG&E with an opportunity to earn a reasonable return that would allow it to maintain an investment-grade credit rating;

- valuable claims against the Parent (which under PG&E's Plan are to be released)[4] and other assets such as PG&E's refund claims pending before FERC would be preserved and transferred to a litigation trust or similar entity and prosecuted for the benefit of PG&E's ratepayers;

- costly and time-consuming preemption litigation would be avoided;

- PG&E would emerge promptly from chapter 11;

- the Commission and State of California would continue to regulate PG&E's operations;

- PG&E's integrated operations would not be disaggregated;

- rates would not increase, and may be reduced in 2003 (or earlier);

- utility assets would not be diverted to pay the Parent's expenses; and

- costly litigation at the FERC, NRC and SEC would be avoided.

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[3] The CPUC expects this number to increase over time.

[4] These claims include, among others, claims that the Parent has violated the "first priority" condition imposed upon the Parent by a Commission order approving PG&E's holding company structure and claims that PG&E declared and paid dividends to its Parent while it was insolvent.

The Alternative Plan reflects the fact that wholesale market prices have declined during the last six months, while the CPUC has increased PG&E's retail rates by over 30% since January 2001. As press reports have noted,

> "The PUC came up with a straightforward plan based on cash flow to put Southern California Edison back in the black. Why can't it do the same with PG&E? If it can, the court should pay attention. Bankruptcy court is supposed to be about debtors paying creditors, not about debtors seeking to shed regulation."

Sacramento Bee, Editorial: "PG&E solution: Nothing? Cash flow may easily resolve bankruptcy," Jan. 10, 2002.

If, as the CPUC anticipates, the Bankruptcy Court terminates PG&E's exclusivity period and permits the CPUC to file the Alternative Plan, it will be impossible to know which, if either, of the two plans the Bankruptcy Court will approve. If the Alternative Plan is approved, the November 30 Filings, including this Application, will be moot.[5]

The November 30 Filings assume PG&E's view of the world. It is far from certain that that view will prevail in the Bankruptcy Court. Should the proceedings in this matter nonetheless proceed, both the NRC and the parties will be required to expend very significant resources vigorously litigating proceedings which may well become moot.[6] There is a better course. The NRC should dismiss PG&E's Application in this

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[5] An illustrative example of how such circumstances should play out is demonstrated by the decision of the FERC in the case of *Committee of Certain Members of Cajun Electric Power Cooperative, Inc.*, 87 FERC ¶ 61,129 (2001) ("*Cajun*"). In *Cajun*, FERC dismissed as premature a petition which was "based on the possibility that the Bankruptcy Court may adopt" one of two pending, competing plans of reorganization. Id. The same result should obtain in this case, both before the FERC and before the NRC.

[6] Such premature litigation is to the detriment of PG&E and its creditors as well as to protesting parties and FERC. For instance, for the month of November 2001, outside counsel involved in the preparation of PG&E's Section 7 filing CP02-39-000 et al. (Winston & Strawn), billed the estate $358,222.38. Counsel involved in the preparation of the ETrans filing, ER02-455-000 (Skadden, Arps), charged PG&E, $410,790.87, for October 2001, and $382,252.71

matter, without prejudice, as premature. PG&E could subsequently re-file any applications necessary to implement an approved bankruptcy reorganization plan at the appropriate time. One thing, however, is sure; in the event that the CPUC's Alternative Plan is adopted, any application to the NRC for a license transfer for DCPP will look very different from PG&E's present Application.[7]

C. THE PREEMPTION HEARING

PG&E's Plan relies heavily on its assertion that central features of the California Public Utilities Code, which are generally applicable to all public utilities in the state, are preempted by the Bankruptcy Code, and consequently that PG&E needs neither to seek nor to obtain approval by the state of any part of the transactions proposed in the November 30 Filings and in the Plan. The CPUC, the State of California, representing other state agencies, and others have objected that PG&E's unlawful misuse of the Bankruptcy Code renders the Plan unconfirmable on its face. That is, under existing law, the Bankruptcy Court cannot lawfully approve the Plan as proposed. The Ninth Circuit has held in *Baker & Drake Inc. v. Public Service Commission of Nevada, 35 F.3d 1348 (9th Cir. 1994), that the Bankruptcy Code does not preempt state sta*tutes or regulations intended to protect the public safety and welfare. According to the Ninth Circuit, state statutes may be preempted by the Bankruptcy Code only if, at a minimum, they are directed narrowly and solely at economic regulation, and if certain other factors apply.

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for November 2001. These figures do not even include amounts billed by Dewey Ballantine, counsel on the Section 203 and other applications.

[7] At the January 16, 2002, hearing the Bankruptcy Court also issued an oral order to show cause as why PG&E and the CPUC should not be required to enter into court appointed mediation, which would be paid for by the Debtor's estate. The Bankruptcy Court has asked these two parties to respond by January 25, 2002.

The provisions of the Public Utilities Code that PG&E seeks to preempt protect the public safety and welfare, and accordingly preemption cannot occur. That is true even if enforcement of the challenged provisions of state law would make a bankruptcy reorganization more difficult, or even impossible. A copy of the CPUC's "Memorandum In Further Support Of Its Objection To Proposed Disclosure Statement For Plan Of Reorganization Under Chapter 11 Of The Bankruptcy Code For Pacific Gas And Electric Company" is attached hereto as Exhibit C.

The Bankruptcy Court held a hearing on the preemption issues on January 25, 2002 and took the issues raised during the hearing under review. A ruling on these issues is expected to occur within the next few weeks. A ruling in the CPUC's favor would doom PG&E's Plan, as it would not be feasible as a matter of law. Such a ruling would require submission, either by PG&E or another party, of a new, lawful, Plan, and moot the November 30 Filings, including PG&E's Application herein. In any event, it is expected that the Court's ruling on these preemption issues are likely to be appealed, and a final resolution of these issues could be many months in the future. It would therefore be an extraordinary waste of resources to proceed on this Application pending the Bankruptcy Court's ruling on the facial preemption issue and the outcome of any appeals of that ruling. Accordingly, the CPUC submits that the NRC should dismiss this Application without prejudice until these preemption issues are finally resolved.

D. ALTERNATIVE MOTION TO STAY PROCEEDINGS

In the alternative, in the event that the NRC declines to dismiss this Application, the NRC should issue an order staying the proceedings in this matter. For the same

reasons set forth above, there is little reason for the parties or the NRC to expend the resources necessary to litigate these proceedings given the current uncertainty as to whether PG&E's plan is lawful, and whether the CPUC will be permitted to submit its Alternative Plan as an alternative plan to PG&E's current Plan.

If the Bankruptcy Court rules against PG&E on preemption, PG&E's Plan falls apart and the November 30 Filings, including this Application, are moot. If the Bankruptcy Court permits the filing of an alternative plan, it will be impossible to know which, if either, of the two plans the Bankruptcy Court will approve.

Accordingly, if the NRC does not determine to dismiss these proceedings altogether, the NRC should certainly to hold the matter in abeyance until the Bankruptcy Court's rulings on the preemption issue and on the filing of the Alternative Plan have been finalized.

II. THE REQUEST FOR AUTHORIZATION TO TRANSFER NUCLEAR DECOMMISSIONING TRUST FUNDS MAY NOT LAWFULLY BE APPROVED BY THE NRC

In its application, PG&E states that decommissioning funding assurance for DCPP is provided by an external Nuclear Decommissioning Trust, as authorized under the Commission's regulations at 10 CFR 50.75(e)(1)(ii), and that PG&E will "transfer" to Diablo the "beneficial interest" in those portions of the CPUC Qualified and Nonqualified Nuclear Decommissioning Trusts (the "Trusts") "associated with" DCPP. Unfortunately, in its filing, PG&E has failed to inform the Commission that it does not have the legal authority to make this transfer. If PG&E cannot transfer its interest in the Trusts to Diablo, the proposed licensee has no decommissioning funding assurance, and

the Commission cannot approve the requested license transfer, because decommissioning funding assurance is a *sine qua non* of Commission approval of any such license transfer.

The reasons why PG&E's beneficial interest in the Trusts cannot be transferred, and thus, the requested license transfer cannot be approved, are as follows: (1) the NRC does not have any direct jurisdiction over these Trusts and accordingly cannot authorize their assignment; (2) the proposed assignment cannot be accomplished without approval of the CPUC, which opposes the transfer; (3) it would be unjust and unreasonable to the California ratepayers who have funded these Trusts to authorize their assignment to a holding company that has no explicit obligation to those ratepayers and that could loot or exploit the Trusts' assets to its own advantage, and to the ratepayers' disadvantage; and (4) the Trusts provide funds for the eventual decommissioning of other PG&E assets -- specifically, Humboldt Bay Nuclear Unit No. 3 ("HB-3") -- which will be retained by PG&E, as well as for the eventual decommissioning of DCPP; thus, on purely practical grounds, the proposed assignment will create serious difficulties and potential inequities in terms of allocating the Trusts' assets as between the needs of DCPP and those other assets.

A. THE NRC LACKS JURISDICTION TO AUTHORIZE ANY ASSIGNMENT OF PG&E'S INTERESTS IN THE TRUSTS

Because the Trusts are not NRC-jurisdictional agreements, the NRC has no authority to approve the transfer proposed by PG&E, nor does PG&E claim that the NRC has any direct jurisdiction over these Trusts (although NRC regulations clearly do require that such trusts be in effect and do impose certain requirements relating to such trusts).

Rather, the Trusts were developed in a vertically integrated environment in which PG&E's nuclear facilities provided energy at retail to California consumers, under CPUC regulation. The parties to the Trust agreements are PG&E, the CPUC and the Trustee, Mellon Bank, N.A. The NRC is not a party to these agreements. The Trusts themselves provide that they were established pursuant to the regulatory authority of the CPUC and the NRC. *See also* Cal. Pub. Util. Code §§ 8321-8330 (the California Nuclear Facility Decommissioning Act of 1985). Any disposition of the Trusts' assets must be pursuant to CPUC order, and to the extent applicable, NRC order.

PG&E does acknowledge that authorization of the assignment of PG&E's beneficial interests in the portions of the Trusts associated with DCPP is "an essential element of the Transaction as the NRC requires Diablo Canyon LLC to have adequate assurance of decommissioning funding." *See* PG&E's Section 203 application to FERC, Docket EC02-31-000, at 72-73. PG&E is correct, of course, that the assignment of the DCPP portion (whatever that is) of PG&E's interests in the Trusts may be necessary under the Atomic Energy Act and NRC regulations to effectuate the transfer of DCPP to Diablo Canyon LLC, but the NRC lacks the authority to "authorize" the assignment of PG&E's interests in the DCPP portion of these trusts to Diablo Canyon LLC or to any other entity.

This is true regardless of any order the Bankruptcy Court may or may not issue. In a footnote in its FERC Section 203 application, PG&E indicates that it will ask the Bankruptcy Court to "compel" the CPUC to approve the transfer or to "deem" the approval to have been granted by the CPUC. *Id.*, at 74, n.57. However, the funds

contained in the Trust are not subject to creditors' claims (except, of course, for claims relating to decommissioning activities for which a proper Disbursement Certificate is submitted to the Trustee)[8] and are therefore outside the purview of the Bankruptcy Court. The Bankruptcy Court therefore has no authority to "break" the contract as part of its approval of a reorganization plan. In any event, even if the Bankruptcy Court may or indeed does issue an order of the type contemplated by the PG&E footnote, such an order would in no way bestow jurisdiction over these Trusts on the NRC.

B. NO TRANSFER OF THE TRUSTS MAY BE ACCOMPLISHED WITHOUT THE APPROVAL OF THE CPUC

As noted above, the Master Trust Agreements that govern the management of the Trusts are contracts between the CPUC, PG&E and the Trustee, Mellon Bank, N.A. The Master Trust Agreements are, by their terms, irrevocable and not transferable. Section 2.07 of the Master Trust Agreement for the Qualified Decommissioning Trust (the larger of the two in terms of asset value) provides as follows:

> "The interest of the Company [PG&E] in the Master Trust is not transferable by the company, whether voluntarily or involuntarily, nor subject to the claims of the creditors of the Company, provided, however, that any creditor of the Company as to which a Disbursement Certificate has been properly completed and submitted to the Trustee may assert a claim directly against the Master Trust in an amount not to exceed the amount specified on such Disbursement Certificate. Nothing herein shall be construed to prohibit a transfer of the Company's interest in the Master Trust upon sale of all or part of the Company's ownership interest in any Plant or Plant's; provided, however, that any such transfer shall be subject to the prior approval of the CPUC." (Emphasis added.)

[8] *See* discussion *infra*.

Section 2.06 of the Master Trust Agreement for the Qualified Decommissioning Trust sets forth identical language.

The Master Trust Agreements thus explicitly deny PG&E the authority to transfer its interest in the Trusts either voluntarily or involuntarily. The only exception is in connection with a sale of PG&E's ownership interest in the plant. However, in such a case, the Master Trust Agreement specifically provides that "any such transfer shall be subject to the prior approval of the CPUC." In its Application in this matter, at page 11, PG&E states that it is seeking to obtain approval from FERC via its Section 203 filing for this transfer of interests in the Trusts to Diablo, without first seeking the approval of the CPUC. However, PG&E's effort to circumvent the required CPUC approval of a transfer of the Trusts by its appeal to FERC on its face violates the terms of its contractual agreement and is accordingly a void and unlawful act.

Ultimately, PG&E's request that FERC "authorize" its assignment of its DCPP-related interests in the Trusts to Diablo is an idle and futile exercise. The one leading authority cited in section V of PG&E's Section 203 application to FERC, which deals with this issue, *Niagara Mohawk Power Corp.*, 89 FERC ¶ 61,124 (1999) in no way supports PG&E's "authorization" request with respect to assignment of PG&E's DCPP-related interests in the Master Trust Agreements. Indeed, if anything, the *Niagara Mohawk* decision undermines the basis for PG&E's request.

In *Niagara Mohawk*, the co-tenants of the proposed transferee of a majority interest in the Nine Mile Point II power plant protested the proposed transfer based on concerns that the proposed transferor might have insufficient funds to meet its portion of

eventual decommissioning expenses, and complained in this regard that the transferor failed to seek FERC approval for the transfer of nuclear decommissioning funds. In its decision, FERC found that there was no need to separately address whether such authorization was needed in that case, and noted that the financial ability of the proposed transferee to fund nuclear decommissioning was a matter to be addressed in an NRC proceeding. Moreover, in *Niagara Mohawk*, FERC explicitly recognized that the proposed transaction was "subject to review by the New York State Commission, and no state commission has argued that the proposed transaction would impair state regulation." *See* 89 FERC, at 61,347. Thus, PG&E's citation to this FERC decision attempts to turn the plain language of the decision inside out. PG&E is attempting to use a finding that holds that the specific authorization of the transfer of decommissioning funds is a matter, not requiring specific FERC approval, for other agencies (the NRC and, in the case of DCPP, the State of California) to decide into a pretext for de facto preemption of the state's clear contractual right to make that policy judgment.

C. ASSIGNMENT OF THE TRUSTS' ASSETS WOULD NOT BE IN THE PUBLIC INTEREST

PG&E contends, at page 74 of its Section 203 application to FERC, without any evidentiary support or analysis, that the assignment of its beneficial interests in the portions of the Trusts associated with DCPP "is consistent with the public interest and is in the public interest." In fact, the opposite is closer to the truth. For instance, the U.S. General Accounting office has just released a report (GAO-02-048, January 2002) finding that the NRC has been approving licensing transfers and related decommissioning

efforts even though new owners and operators are unable to assure regulators that the money for decommissioning will be there when reactors are ready for burial.

The specific question of whether the transfer of a nuclear decommissioning fund would be in the public interest, was examined in detail by the CPUC several years ago in a case, A.97-12-039, involving the application of San Diego Gas and Electric Company (SDG&E) for authority to sell its share of the San Onofre Nuclear Generating Station ("SONGS"). There, even SDG&E's partner in SONGS, Southern California Edison Co. ("Edison") expressed concern regarding the proposed transfer, questioning how ratepayers can be assured of protection if a decommissioning trust fund is dissipated by a new, non-utility owner after the transfer. (*See* RT of October 21, 1999 hearing in CPUC Docket A-97-12-039, at 22.) PG&E does not even suggest an answer to that question, either in its Application in this matter or in its voluminous Section 203 application to FERC, which also addresses the proposed transfer of PG&E's beneficial interest in the Trusts to Diablo. However, this question is as compelling today in the context of the transfer that PG&E is requesting the Commission to authorize herein as it was 2½ years ago in the SONGS proceeding.[9]

It should also be noted that California's decommissioning law is stricter than required by the NRC. Pursuant to the California Nuclear Facility Decommissioning Act of 1985 (Pub. Util. Code §§ 8321 through 8330), California's nuclear power plants generally have considerably more money in their decommissioning trust funds than do

[9] It should be noted that on November 5, 1999, SDG&E withdrew its request to divest its interest in SONGS. *See, In the Matter of the Application of San Diego Gas & Electric Company (U-902-E) for Authority to Sell Electrical Generation Facilities et al.*, D.00-10-054, 2000 Cal. PUC LEXIS 760 (2000).

the plants in most other states. This is because most other states typically only require compliance with NRC rules. Under this California law, not only must more money be put into such funds (the maximum contribution allowed pursuant to section 468A of the U.S. Internal Revenue Code, and applicable regulations adopted pursuant thereto), but also California has the oversight authority to make sure that the decommissioning work gets done in a timely fashion. Under CPUC oversight, PG&E has been a good steward of the Trusts, to date.

However, there is absolutely no guarantee that a Diablo Canyon LLC or some other entity that is not regulated by the CPUC would maintain that stewardship. And yet, the transfer of PG&E's "beneficial interest" in the portions of the Trusts associated with DCPP will effectively put much of the Trusts assets in the hands of such a less reliable and less trustworthy entity, over which, in PG&E's view, neither FERC nor the CPUC would have regulatory authority. Such an unregulated entity would have a strong financial incentive to delay performing the decommissioning as long as possible, in order to make as much money for itself, using ratepayer provided funds. It would not be in the public interest, and it would be unjust and unreasonable to PG&E's ratepayers, who have footed the bill for the eventual decommissioning of DCPP, to allow such a situation to arise.

D. THE IMPRACTICALITY OF ASSIGNING THE TRUSTS' ASSETS

Based on information contained in the most recent annual report (for calendar year 2000) from PG&E's Nuclear Facilities Decommissioning Master Trust Committee ("NFDMTC"), there is currently a total of some $1.462 billion of assets in the Trusts. At

page 11 of the Application, PG&E states that approximately $1.101 billion of this sum is the "liquidation value" of the DCPP portion of the Trusts. It is important to note, however, that the Trusts are intended to cover decommissioning costs for the shut down of both HB-3 and the DCPP units. By their terms, the Trust documents do not allocate any given amount of the funds controlled by the Trusts to either plant.

PG&E attempts to sweep this serious problem under the rug by blithely asserting in a footnote (at page 11 n.10 of the Application) that all of the funds in the Trusts associated with HB-3 will be "segregated" from the DCPP components of the Trusts as part of the larger transaction that PG&E is requesting FERC to approve. Unfortunately, nothing in the Application indicates how this "segregation" will take place. Nor does PG&E explain how such a "segregation" is consistent with, or permitted by, the Trust documents.

Even if it were both lawful and achievable to so segregate the Trust funds, given the unpredictable nature of decommissioning activities, it would be unreasonable and impractical to attempt to allocate the Trusts into separate HB-3 and DCPP components without a detailed study of the likely scope of the decommissioning effort required for each facility. Such a study would be a lengthy, complicated and expensive endeavor. However, without a proper allocation of Trust assets to HB-3 and DCPP based on a prudent and thorough analysis of the likely costs of decommissioning for both facilities, there is a significant likelihood that one or the other of the facilities would have too few funds to properly complete decommissioning, thereby resulting, especially in the case of HB-3, in an unnecessary, unjust and unreasonable adverse impact on PG&E's ratepayers,

and potential health, safety, and welfare concerns for California citizens. Thus, assuming, *arguendo*, that some entity other than the CPUC had the authority to divide the corpus of the Trusts and to assign some share of the Trusts' assets that would be allocated to DCPP to Diablo, and notwithstanding PG&E's unsupported statement of the liquidation value of the DCPP component of the Trusts, it would be improper, imprudent and impractical to do so absent the results of a detailed study which has not yet even been commenced.

III. THE PROPOSED TRANSFEREE IS NOT FINANCIALLY QUALIFIED TO BE THE NRC'S LICENSEE FOR THE DCPP

The license for DCPP should not be transferred to Gen, because, as the discussion below amply sets forth, Gen's finances are highly questionable. It is accordingly uncertain that Gen will have the resources to carry out the critical plant maintenance and public safety-related functions that will enable the DCPP to continue to meet the Commission's rigorous regulatory requirements. It would be imprudent in the extreme to license untested, financially unstable entities to own and operate a commercial nuclear reactor, an installation that must meet critically high standards of operations and maintenance.

As part of its Reorganization Plan, PG&E would divest most of its generation assets, including DCPP, to Gen, and would then enter into a Purchase & Sale Agreement ("PSA") to buy back the power output of DCPP for the next twelve years. This proposal is seriously flawed, because the rates proposed in the PSA are unjust and unreasonable, and FERC cannot legally or properly approve them. Assuming that FERC properly

determines that Gen should only be allowed to collect cost-based rates for DCPP, there will simply not be enough money coming in to both operate the plant properly, and to service the debt to be incurred by Gen under the Plan. Under such circumstances, Gen will be in no position to satisfy the requirement of the Commission's regulation, at 10 CFR 50.33(f)(2), that a non-utility applicant (such as Gen would be) must have reasonable assurance of obtaining the funds necessary to cover the plant's estimated operating costs.

The CPUC is currently attempting to thwart this scheme in a motion contesting PG&E's Federal Power Act Section 203, 204 and 205 filings with FERC, as well as before the Bankruptcy Court. Copies of the CPUC's filings in these three FERC Dockets, EC02-31-000 (the "203 application")[10], ES02-17-000 ("the 204 application")[11] and ER02-456-000 (the "Gen 205 application")[12] are attached hereto as Exhibits D, E and F, respectively. The CPUC incorporates the substance of those filings by reference, as if fully set forth herein. Should the CPUC prevail on any of the issues it has raised in those FERC proceedings (or on the legal and policy issues the CPUC has raised in the Bankruptcy Court, which are discussed above), the house of cards on which PG&E's applications, both to this Commission and to FERC, are based, will quickly collapse. In

[10] In its 203 application, PG&E requests, among other things, that FERC authorize it to transfer to Diablo Canyon LLC, one of the subsidiaries of Gen, its beneficial interest in the Nuclear Decommissioning Trusts associated with DCPP.

[11] Gen plans to finance acquisition of DCPP through the issuance of bonds, which it asks FERC to authorize in the 204 application. However, under §204 of the Federal Power Act, FERC clearly lacks jurisdiction to do so. FERC must accordingly deny PG&E's 204 application on its merits.

[12] In the Gen 205 application, PG&E seeks, among other things, approval by FERC of a power sales agreement whereby Gen would enter into a 12-year contract to sell the power output of DCPP to PG&E for a specified price.

such event, Gen will not be a financially viable entity, and will thus be rendered, beyond any doubt, unqualified to hold the license for DCPP. For this reason alone, the Commission should dismiss the application under review in this proceeding, or, at least, hold the requested license transfer in abeyance until the disposition of PG&E's restructuring plan is settled by the Bankruptcy Court. The Declaration of David R. Effross, which is attached hereto as Exhibit G, provides evidentiary support for the following analysis showing why Gen will not be a financially viable entity.

A. GEN WILL NOT BE A FINANCIALLY VIABLE ENTITY

PG&E's Plan proposes to transfer PG&E's electric generation, electric transmission, and natural gas transportation facilities to PG&E's Parent, PG&E Corporation, leaving a Reorganized PG&E to emerge from bankruptcy as an under funded distribution-only utility possessing only assets and liabilities not desired by the corporate parent. Included is a proposal to transfer all of PG&E's hydroelectric and its operating nuclear generation facilities *(i.e.*, DCPP) to Gen, and then to transfer Gen to the corporate Parent by means of an unlawful stock dividend in violation of § 305 of the Federal Power Act (*see* Exhibit D).

Should the various transactions proposed in PG&E's Plan be approved, PG&E proposes that Gen enter into a proposed Purchase & Sale Agreement ("PSA") with Reorganized PG&E. Under the PSA, Gen proposes to sell all of the output of the (former) PG&E generation facilities to Reorganized PG&E for an eleven year period at an unjust and unreasonable price, approaching double the rates PG&E would receive for the output of the facilities in the absence of the proposed transactions, and justified only

by the need to service the unnecessary debt which Gen proposes to incur upon receipt of the facilities (the PSA includes a twelfth year for approximately half of the facilities' output). Under this Plan, as noted in part I above, only Reorganized PG&E would be subject to CPUC regulation.

The terms of the PSA are spelled out in PG&E's Gen 205 application. The CPUC's preliminary review of the Gen 205 application (which is summarized in Exhibit F) discloses strong indications that the pricing, terms and conditions of the PSA are not just and reasonable, and thus, may not be approved by FERC.

PG&E has wholly failed to meet FERC's standards applicable to power sales agreements between affiliates. Moreover, under the circumstances here, the applicable standards must be applied with extraordinary scrutiny. The PSA was not reached at arm's-length by entities with competing interests, but rather was developed by the same counsel working simultaneously for all the (affiliated!) parties, one of which is essentially non-existent. PG&E concedes that the PSA was developed, on behalf of both the "buyer" and "seller" by a single "Team [which] developed the price, terms and conditions of the PSA."[13]

B. THE RATES IN THE PROPOSED PSA ARE UNJUST AND UNREASONABLE TO REORGANIZED PG&E AND ITS RETAIL CUSTOMERS WHO WILL FOOT THE BILL

The heart of the Gen 205 application is PG&E's contention that the rates in the proposed PSA are just and reasonable to Reorganized PG&E on the basis of a

[13] See Exhibit 1 (Kuga Testimony) to PG&E's Gen 205 application, at 11.

"benchmark" analysis conducted by PG&E's witness Meehan. However, as set forth in detail below, PG&E's "benchmark" analysis misses the mark. First, the rates in the proposed PSA must properly be evaluated not against other long-term power transactions, but rather against the rates which PG&E would receive in the absence of the proposed Spin-Off and related transactions. That is, the proposed PSA rates must be compared against the CPUC's rates for Utility Retained Generation. Second, even if it is appropriate to measure the proposed PSA against "comparable" wholesale transactions, PG&E's benchmark analysis fails to establish that the proposed PSA rates are just and reasonable. Third, PG&E fails to provide a cogent analysis of its market power. Consequently, PG&E fails to establish that the price and non-price terms and conditions of the PSA are just and reasonable, and that the PSA is not fatally tainted by self-dealing.

1. The Proposed PSA Rates Must be Evaluated in Comparison with Otherwise Applicable Rates

Under PG&E's proposal, Gen will sell the output of the electric generation facilities currently owned and operated by PG&E to Reorganized PG&E, which would in turn resell the facilities' output to its retail customers. In the absence of the transactions proposed in PG&E's Plan, PG&E would retain the electric generation assets which it proposes to transfer to Gen and to the subsidiaries of Gen, including, in this case, to Diablo Canyon LLC, and would continue selling the output of the generation facilities directly to its retail customers.[14] Under either scenario PG&E's retail customers will receive the same energy and Ancillary Services from the same facilities. Thus, the

[14] As discussed in greater detail in part I above, the CPUC has formulated an Alternative Plan under which PG&E would be able to emerge from bankruptcy without disposing of its electric generation assets.

appropriate comparator against which to measure the PSA is the utility-retained generation ("URG") component of PG&E's retail rates.

Under current California law and CPUC policy, such rates are determined on a traditional cost-of-service basis. *See, e.g., Application of San Diego Gas & Electric Company et al.*, D.01-12-015, 2001 Cal. PUC LEXIS 1072, *7 ("We intend to apply cost-based ratemaking to all of SDG&E's retained generation assets . . . which we believe is consistent with ABX1 6"); *Application of Southern California Edison Company et al.*, D.01-01-061, 2001 Cal. PUC LEXIS 30 ("PG&E, SDG&E and Edison shall establish a cost-based rate for URG"). The CPUC has expressly rejected PG&E's request to set its URG revenue requirement based on market valuation rather than cost-of-service. *Application of Southern California Edison Company et al.*, D.01-10-067, 2001 Cal. PUC LEXIS 959 ("We determine that market valuation does not apply to setting a prospective revenue requirement for PG&E's URG assets").

PG&E's witness Meehan states that the levelized price over the twelve-year period of the PSA is approximately $52.29/MWh.[15] Elsewhere, PG&E asserts that the average price under the contract over the life of the contract is approximately 5.1 cents/kWh ($51/MWh).[16] That the contract costs are unjust and unreasonable as to Reorganized PG&E (and to its retail ratepayers) is confirmed by PG&E's own numbers. In its Plan, PG&E projects revenues under the contract of approximately $1.5 billion annually. For calendar year 2003, PG&E projects revenues under the contract of $1,471,500,000. (*See*

[15] The testimony of Mr. Meehan is set forth in Exhibit 2 to PG&E's Gen 205 application.

[16] See PG&E's Gen 205 application, at 3.

a page from PG&E's Plan, which is attached to Exhibit F hereto as "Exhibit A.") Based solely on the numbers presented by PG&E in its Plan, PG&E's revenue requirement based on traditional cost-of-service principles would be approximately $790.4 million for 2003—about half of PG&E's projected revenues. This translates to an illustrative rate of approximately 2.5 cents/kwh.[17]

This calculation proceeds as follows: PG&E's Plan projects total operating expenses for Gen in 2003, including depreciation, of $759.7 million. From this figure is subtracted "other income" of $88.9 million, leaving net operating expenses of $670.8 million. To this is added a rate of return and taxes of $119.6 million, calculated utilizing PG&E's projected 2003 net plant shown in the Plan of Reorganization for the nuclear and hydro assets of $913.8 million and PG&E's rate of return grossed up for income tax authorized by the CPUC of 13.09%.[18] This results in an illustrative cost-of-service revenue requirement for Gen, using PG&E's own figures, of $790.4 million for 2003.

The illustrative cost-of-service revenue requirement of $790.4 million is 53.7% of the proposed revenues PG&E would receive under the PSA in 2003 of $1,471.5 million. PG&E asserts that rates under the PSA in 2003 would be approximately 4.6 cents/kWh. Since, as PG&E asserts, revenues of $1,471.5 million equates to 4.6 cents/kWh on average, the cost-of-service revenue requirement is approximately 2.5 cents/kWh on

[17] This pleading does not purport to determine the rate which the CPUC would actually set for PG&E's URG for any particular customer or class of customers, but simply utilizes figures provided by PG&E to provide, for illustrative purposes, a rough calculation of a cost-of-service rate based on such figures.

[18] PG&E's Plan shows higher figures for return, interest expense, and taxes, totaling $800.8 million, because the figures reflect and are being used to support the borrowing of over $2 billion to help pay off creditor claims. The $119.6 million in the calculation above includes interest expense on the net plant of $913.6 million, as it is based on a 13.09% weighted average rate of return that includes interest and taxes. *See* PG&E work papers submitted in CPUC Docket No. A.00-11-038, Scenario 1.

average (.537 x 4.6 cents/kWh) for 2003.[19]

While a rate of 2.5 cents/kWh is low compared to recent prices for gas-fired generation, the rate reflects the resource mix utilized for the PSA and PG&E's actual costs—not including the cost of unnecessarily borrowing over $2 billion. PG&E's hydroelectric resources are highly depreciated. PG&E's nuclear and hydro pumped storage resources, including DCPP, have been subject to accelerated depreciation during the transition period established under California's deregulation law. Ratepayers have paid several billion dollars of accelerated depreciation through California's Competitive Transition Charge, and would be losing a good portion of what they paid for under PG&E's Plan of Reorganization. *See also* the proposed decision addressing PG&E's revenue requirement for utility-retained generation ("the URG PD") recently issued by a CPUC Administrative Law Judge.[20]

While these figures may be subject to some refinement, this illustration demonstrates that the PSA is grossly overpriced. If the PSA were approved as proposed, PG&E's ratepayers would make some $700 million in excess payments to Gen over and above the otherwise applicable rate for the same energy from the same facilities in 2003. Over the life of the PSA, the overpayments approximate $8 billion.

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[19] A recent report issued by the consumer group TURN estimates the "Expected Price Under Regulation" at approximately 2.5 cents/kWh in 2003, and 2.9 cents over the term of the PSA. *See* "Highway Robbery: Unmasking the PG&E Bankruptcy Plan's Financial Impact on California Consumers," available at http://www.turn.org/turnarticles/PG&E_report.pdf.

[20] California law generally requires the CPUC's proposed decisions to be released for comment prior to a Commission vote. See Cal. Pub. Util. Code § 311(d), (g). The URG PD is available from the CPUC's web site, at http://www.cpuc.ca.gov/published/comment_decision/12655.htm. An alternate proposed decision of CPUC Commissioner Lynch is available at http://www.cpuc.ca.gov/published/Agenda_decision/12659.htm.

2. PG&E's Benchmark Analysis is Invalid

Assuming, *arguendo*, that the benchmark analysis utilized by FERC in connection with previous affiliate transactions is applicable, PG&E's benchmark analysis, supported by the testimony of witness Meehan, is invalid for a number of reasons, discussed below.

FERC has articulated standards pursuant to which it will accept power sales contracts between affiliates in a series of three orders over the past ten years. *Boston Edison Co. Re: Edgar Electric Energy Co.*, 55 FERC ¶ 61,382 (1991) ("*Edgar*"); *Ocean State Power II*, 59 FERC $61,360 (1992), reh'g denied, 69 FERC ¶ 61,146 (1994) ("*Ocean State*"); *Ameren Energy Mktg. Co.*, 96 FERC ¶ 61,306 (2001) ("*Ameren*"). In *Edgar*, FERC stated that such arrangements will be permitted if two conditions are satisfied. First, FERC requires a showing that there exists no potential abuse of self-dealing or reciprocal dealing. Second, if there has been a showing of no potential abuse of self-dealing or reciprocal dealing, FERC has found that market-based rates may be acceptable if the seller can also demonstrate that it lacks market power (or has adequately mitigated its market power), under familiar principles. *Edgar*, 55 FERC at 62,167.

As PG&E recognizes, the potential for self-dealing is present here, where the seller under the proposed PSA is essentially non-existent, and the terms and conditions of the PSA were developed by a single entity acting on behalf of both the putative seller and buyer. The risk of self-dealing is at its height in this transaction, in which the buyer under the proposed PSA would, if PG&E's Plan is confirmed, be stripped of all of its most valuable assets and the affiliate relationship then terminated.

FERC has articulated three means by which lack of self-dealing or reciprocal

dealing may be shown, to ensure that an affiliated "buyer has chosen the lowest cost supplier from among the options presented, taking into account both price and non-price terms (i.e., that it has not preferred its affiliate without justification"). *Edgar*, 55 FERC at 62,168. PG&E has chosen to present "benchmark evidence" of market value, i.e. evidence of other relevant power sales agreements between non-affiliates, which it claims demonstrates that the PSA is not unreasonable.[21] Under the *Edgar* line of cases, the benchmark sales must be: (1) transactions in the relevant market; and (2) should be contemporaneous with; and (3) involve service that is comparable to, the instant transactions. In addition, FERC requires that the benchmark analysis examine non-price as well as price terms, and assumptions used in comparing the various projects should be explained with respect to both price and non-price terms. Finally, the applicant must demonstrate that the benchmark evidence was not distorted by the exercise of market power by the seller or its affiliates. *Ocean State*, 59 FERC at 62,333. FERC has observed that it must "take into account the evolving nature of our analyses of market-based affiliate transactions," including changes to the national generation market. *Ocean State*, 59 FERC at 62,332.

PG&E contends that the relevant market is "the market for firm, long-term baseload and peaking capacity and energy for a duration of approximately 10-15 years with a start date expected near January 2003," and that the relevant region must be limited to suppliers which can deliver energy to PG&E.[22] PG&E contends that the

[21] See PG&E's Gen 205 application, at 14 ff.

[22] See PG&E's Gen 205 application, at 17.

relevant "contemporaneous" period is May 2000 through November 2001.[23] By so attempting to confine the analysis, PG&E contends that the appropriate benchmark sales are nine long-term contracts entered into by the California Department of Water Resources ("DWR") during 2001.

PG&E's Reliance on DWR Contracts

In confining its benchmark comparison to the DWR contracts, PG&E has sought to define as the relevant period precisely the same period in which the California wholesale electricity markets exhibited extreme dysfunction. PG&E has previously characterized this as a period of "massive market failure and upheaval in the regulatory regime that has led to billions of dollars in overcharges since May 2000."[24] Similarly, PG&E has attempted to confine its benchmark comparison to DWR contracts, the negotiation of which PG&E has previously contended were subject to the exercise of market power, and as to which PG&E has contended FERC ought to order refunds.[25] As PG&E stated in its Request for Rehearing of FERC's July 25, 2001 order (*San Diego Gas & Electric Company, et al.*, 97 FERC 61,275 (2001), filed in Docket No. EL00-95 on August 24, 2001, at 12:

> "the DWR bilaterals . . . have drawn the most attention. These transactions are not bilateral purchases in the conventional sense with a willing buyer and a willing seller. Rather, they reflect the state stepping into the shoes of insolvent utilities as the default buyer of power in order to

[23] *See* PG&E's Gen 205 application, at 18.

[24] *See* PG&E's Request for Rehearing of FERC's July 25, 2001 order *(San Diego Gas & Electric Company, et al.*, 97 FERC 61,275 (2001), filed in FERC Docket No. EL00-95 on August 24, 2001, at 19.

[25] FERC has not found any specific DWR contracts to be "just and reasonable." *See, e.g., GWF Energy*, 97 FERC 61,297 (2001), slip op. at pp. 3-4.

backstop the ISO's efforts at maintaining reliability in a dysfunctional market."

PG&E's reliance on the DWR contracts for its benchmark analysis is fatal. The DWR contracts were negotiated and executed during a period of extreme exercise of market power, as FERC has acknowledged on repeated occasions. FERC has expressly recognized that the exercise of market power in the spot markets extended to the forward markets during the time period to which PG&E seeks to confine the analysis.[26] Thus, the DWR contracts cannot be relied on to be a benchmark of market value in a competitive market, and cannot be relied on to demonstrate that the PSA reflects a competitive market value.[27]

The Relevant Market

In *Ocean State*, FERC indicated that a benchmark analysis should consider as the geographic market suppliers that can supply the relevant product to the buyer. *Ocean State*, 59 FERC at 62,333. However, FERC also expressly stated that its analysis and holding in *Ocean State* were confined to the facts of that proceeding. *Ocean State*, 59 FERC at 62,338 n. 117. With respect to the PG&E reorganization, it is inappropriate to consider only a geographic market centered on PG&E's service territory. First, as discussed above, an analytic limitation to contracts in PG&E's California service territory focuses the analysis on an environment of acknowledged market power.

[26] *San Diego Gas & Electric Company, et al.*, 93 FERC ¶61,121 (2000) at 61,358 ("higher spot prices in turn affect the prices in forward markets"); *San Diego Gas & Electric Company, et al.*, 95 FERC ¶ 61,418 (2001), at 62,556 (expanded spot market mitigation plan "will, over time, impact bilateral and forward markets as well"); *see also AEP Power Marketing, Inc.*, 97 FERC ¶ 61,219 (2001).

[27] Only a competitive market value is relevant to an analysis under section 205 of the Federal Power Act to determine whether a proposed rate is just and reasonable, as "t]he prevailing price in the marketplace cannot be the final measure of 'just and reasonable' rates mandated by the Act." *FPC v. Texaco*, 417 U.S. 380, 397 (1974).

Second, a broader geographic market is appropriate to consider in this case due to the nature of the PSA. The PSA is a long-term agreement with a delayed implementation date. Developed in 2001, it is proposed that the PSA run from January 2003 through 2014. The market for such contracts is decidedly national, not regional. That is, a seller need not be physically located in California in 2001 in order to provide power under a 12-year contract commencing in 2003. Because of the long duration and delayed implementation date, a seller would have sufficient time to build new facilities to satisfy all but the earliest segments of the twelve year period.

That the long-term market for electric generation is essentially national rather than regional is confirmed by an examination of regional pricing for forward electricity contracts. During the height of the recent California energy crisis, western forward prices were substantially higher than forward contracts at other national trading hubs -- as much as an order of magnitude higher. Since FERC's summer 2001 orders restored a measure of stability to western markets, however, forward contract prices at various regional hubs have tended to converge. For instance, as of December 12, 2001 (when the notice was issued in this proceeding) the simple average of reported futures prices for calendar year 2002 were $30.66 for the California-Oregon border ("COB"), $34.25 for PJM, and $30.80 for CINergy.[28] Longer-term prices should show similar convergence. As the relevant market for products similar to the PSA is a national rather than regional market, and PG&E analyzes only a corrupted regional market, PG&E's benchmark analysis fails to satisfy the "relevant market" prong of the benchmark analysis.

[28] See www.enerfax.com. By late January 2002, prices in all three markets had declined.

Contemporaneousness

PG&E's benchmark analysis similarly fails to satisfy the "contemporaneous" prong articulated in the relevant cases. PG&E examined only contracts "entered into between May 2000 and the date of this Application."[29] Meehan's benchmark analysis focuses on nine contracts entered into between February and August 2001 as his "comparison group."[30] As discussed above, this is precisely the period in which all energy transactions in the California markets were tainted with market power. It is patently unreasonable to consider only such contracts. Moreover, this period is not contemporaneous with the period in which the PSA was developed. PG&E filed its Plan with the Bankruptcy Court on September 20, 2001; however, the key event in this scenario is the order issued by FERC on June 19, 2001, which quickly restored a semblance of stability to the California markets. All of the contracts in witness Meehan's "comparison group" were either executed or had an executed letter of intent no later than June 22, 2001.[31] That is to say, the negotiation of all of the comparison group contracts took place in the market power period. By the fall of 2001 when the PSA was developed, forward contract prices in California had already begun to converge with forward prices in regional markets across the country, at prices well below the prices in the PSA. PG&E has thus failed to examine any contemporaneous contracts in its benchmark analysis.

In *Ocean State*, FERC approved a benchmark analysis, which considered as the

[29] *See* PG&E's Gen 205 application, at 18.

[30] *See* PG&E's Gen 205 application, at 20-21.

[31] *See, California State Auditor*, "California Energy Markets: Pressures Have Eased, But Cost Risks Remain," 193-195, Table 10. The report is available at http://www.bsa.ca.gov/bsa/pdfs/2001009.pdf

relevant period late 1987 into 1989, "reflecting the period during which the purchasers made their decisions to contract with Ocean State II." *Ocean State*, 59 FERC at 62,334. PG&E provides no similar justification for the period it has chosen. Certainly, PG&E makes no claim that that the roughly eighteen month period it has selected for examination represents the only, or even the most relevant, time period in which buyers seeking energy for the 2003-2014 period would have, or did, engage in negotiations.

The CPUC has no principled objection to a "contemporaneous" period of roughly eighteen months. But PG&E has disingenuously selected the precise 18 months in which the California market was at its most dysfunctional. Were there no long-term power contracts entered into in the western United States in the first quarter of 2000? In the last quarter of 1999? Or, for that matter, in the truly contemporaneous period – the third and fourth quarters of 2001? The "contemporaneous" period selected by PG&E is invalid on its face, particularly when coupled with the limited geographical market also selected by PG&E. Any valid benchmark analysis must, if not be limited to, certainly include an examination of contracts executed during a period of relative market stability. Such a period could include, for instance portions of 1999 and 2000, and the latter third of 2001. Evidence as to whether and to what extent buyers sought long-term contracts for period comparable to the PSA during these periods can be presented at hearing.

Comparability

As PG&E observes, FERC has held that benchmark evidence must encompass "similar services when compared to the instant transaction." *Edgar*, 55 FERC at 62,129; *Ocean State*, at 62,333. PG&E's benchmark analysis fails this requirement as well. In

the instant case, the PSA provides for capacity and energy from approximately 7,100 MW of hydroelectric and nuclear power plants. The size of the PSA alone disqualifies each of the purported "comparison group" contracts from consideration as comparable. PG&E witness Meehan admits that he must treat each of the comparison group contracts as "infinitely scalable" in order to make a comparison.[32] In *Ocean State*, the applicant provided comparison evidence relating to 33 projects. FERC confined its analysis to the ten projects which were "comparable to Ocean State II with respect to size and technology." *Ocean State*, 59 FERC at 62,334. Similarly, in *Edgar*, FERC rejected a benchmark showing in part due to the applicant's failure to evaluate the proposed rates against truly comparable projects. *Edgar*, 55 FERC at 62,169 ("Boston Edison's comparison of projects [against a 306 MW combined-cycle generating unit] includes projects as small as 0.7 MW and powered by wind, wood, waste, peat and hydropower"). Here, of course, the facilities proposed to support the PSA are exclusively hydroelectric and nuclear generating plants. The "comparison group" contracts, to the extent that they have any specific source of generation attached to them, are exclusively natural gas-fired units. The PSA is for some 7,100 MW. Only one of the comparison group contracts is within the same order of magnitude. The comparison group contracts are comparable in neither size nor technology to the PSA.[33]

[32] See PG&E's Gen 205 application, at 27, and Exhibit 2 to the Gen 205 application, at 25.

[33] PG&E declines to provide benchmark evidence regarding "buy-back" agreements executed in recent years in connection with sales of nuclear facilities in New York, or with fairly large hydroelectric portfolios elsewhere in the U.S.

Price

The foregoing establishes that PG&E's benchmark analysis fails to establish the absence of self-dealing in the development of the PSA. As such, the PSA may not be accepted. *Edgar*, 55 FERC at 62,170. Moreover, the proposed rates in the PSA are simply too high to be considered just and reasonable. For instance, the capacity charges in the first year of the PSA amount to $170.75/kW-year.[34] Specifically, the capacity charges are $20.50/kW-mo for the peak months of July and August, $15.25/kW-mo for June, September, and October, and $12/kW-mo for November through May. The capacity payment is paid on a portfolio of 7,100 MW of capacity.[35] Thus the capacity payments alone under the PSA, in the first year, amount to over $1.2 billion, and escalate to nearly $1.5 billion in year eleven.

FERC recently addressed another power sales agreement between affiliates in *Ameren*. The contract is for a minimum of 350 MW of capacity and energy per hour from June 2001 through May 2002. In the affiliate contract at issue in *Ameren*, the maximum capacity charge is $4/kW-mo. The minimum capacity charge in PG&E's PSA exceeds that by 300 per cent.

At this juncture, one point should be clear: the value of PG&E's Plan to Gen exceeds the revenues that Gen would receive under the PSA. Under the Plan, Gen will receive not only $52.29/MWh for twelve years, but in addition, Gen will receive virtually all of PG&E's electric generation assets for a fraction of their value. Gen will effectively

[34] See Exhibit 1 (Kuga testimony) to PG&E's Gen 205 application, at 6.

[35] See Exhibit 1 (Kuga testimony) to PG&E's Gen 205 application, at 5.

pay reorganized PG&E $2.4 billion for PG&E's hydroelectric assets and DCPP.[36] Gen thus proposes to acquire the hydro and nuclear assets for less than PG&E has previously proposed as the market value for the hydro facilities alone.[37]

The foregoing facts demonstrate that the PSA cannot appropriately be considered in isolation. However, any substantive evaluation of the PSA must consider related issues including the value to Gen of obtaining the PG&E generating facilities for a fraction of their PG&E-proposed market value.

3. PG&E's Market Power Analysis is Woefully Insufficient

The *Edgar* line of cases requires an applicant in an affiliate sales case to make two separate market power showings. First, PG&E must demonstrate that "the benchmark evidence was not distorted by exercise of market power by the seller or its affiliates." *Ocean State*, 59 FERC at 62,333. In this regard, FERC is concerned that, "If the seller or any of its affiliates has exercised market power and thus kept prices high in the relevant market, the benchmark evidence would be skewed in favor of the seller and thereby allow the affiliated buyers to give an undue preference to the sellers." *Ocean State*, 59 FERC at 62,337. In the Gen 205 proceeding, FERC must address not only whether PG&E has exercised market power and thus skewed the benchmark evidence, but rather whether any party exercised market power in connection with the benchmark evidence. That is, a

[36] See PG&E's Gen 205 application, at 2. Upon receiving the generating facilities from PG&E, "Gen will then transfer cash and notes to PG&E amounting to $2.4 billion".

[37] See Exhibit D, at 17-33. The market value of the hydro facilities was set at $2.8 billion in a settlement agreement proposed by PG&E, TURN, and other parties in CPUC Docket No. A.99-09-053, but which was not approved by the CPUC. PG&E subsequently proposed a market value of $4.1 billion for the hydroelectric facilities alone in CPUC Docket No. A.00-11-056.

proper market analysis in this proceeding must consider whether the benchmark evidence was skewed by the exercise of market power. As discussed above, there is no doubt that it was. Accordingly, the benchmark evidence is invalid, and cannot be used to support the PSA.

Second, if there has been a showing of no potential abuse of self-dealing or reciprocal dealing, FERC has found that market-based rates may be acceptable if the seller can also demonstrate that it lacks market power (or has adequately mitigated its market power), under familiar principles. *Edgar*, 55 FERC at 62,167. As PG&E requests acceptance of the PSA as market-based rate,[38] PG&E must satisfy this standard (although, as is noted above, PG&E has not demonstrated the lack of abuse of self-dealing).

PG&E currently possesses in excess of, and Gen proposes to acquire, 7,100 MW of generation. PG&E's contention that a supplier of such magnitude in frequently constrained Northern California does not have market power fails the straight face test. Indeed, PG&E has been among the loudest voices arguing that suppliers with much smaller portfolios have both possessed and abused market power.[39]

Whether measured by the now-disregarded hub-and-spoke methodology or the

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[38] *See* PG&E's Gen 205 application, at 14 n. 13.

[39] *See, e.g.*, "Late Motion to Intervene and Protest of Pacific Gas & Electric Company and Southern California Edison Co." in FERC Docket No. ER99-1722-004, filed April 3, 2001, at 7 ("because the premises on which Williams based its market power analysis are no longer valid, and because of the clear evidence that Williams can exercise market power in the WSCC, the Commission's review should lead to a suspension of Williams' market-based rate authority") (emphasis added) and "Testimony of James Wilson for PG&E" in FERC Docket No. EL00-95-000 at 10-16 and Figures 1, 2 and 5 (unrebutted testimony demonstrating that conditions in the California marketplace have permitted the exercise of market power, bidding without adequate competition by pivotal suppliers, and existence of Cournot pricing conditions during potentially 4000 hours in 2001).

Supply Margin Assessment ("SMA") screen established in *AEP Power Marketing, Inc.*, 97 FERC ¶ 61,219 (2001) ("AEP"), PG&E indisputably possesses market power. At best, PG&E's showing -- i.e. that it is a net purchaser rather than a net seller of electricity, and that its generation resources are currently required both by state and federal regulation to be devoted to native load -- demonstrates that under current circumstances it has little incentive to exercise the market power it possesses.[40] All this, of course, will change should PG&E's Plan be implemented. Gen would become a stand-alone merchant seller with the largest single generation portfolio in California, and one of the largest generation portfolios in the country. Moreover, although the Gen 205 application is a new market-based rate application submitted after the announcement of the SMA screen in AEP, PG&E has failed to perform an SMA analysis. Nor has PG&E submitted a hub-and-spoke analysis.

In sum, there can be no question that a supplier with a generation portfolio of the magnitude at issue here in Northern California possesses market power.

4. In Light of the Inadequacies of PG&E's Showing, and the Unique Aspects of the Proposed PSA, Only Cost-based Rates May be Accepted as Just and Reasonable

PG&E's Gen application to the FERC wholly fails to satisfy the applicable standards necessary to support the rates in the proposed PSA, or any market-based rates. Due to the unique nature of both the proposed transaction and the magnitude of the generation portfolio supporting it, it is unlikely that PG&E could make a showing that satisfies the benchmark standards and effectively rebuts the presumption of self-dealing

[40] See PG&E's Gen 205 application, at 34-35.

which must be drawn from the facts at issue here.

PG&E has asserted that other suppliers in California should be subject to cost-based ratemaking. For instance, in PG&E's Request for Rehearing of FERC's July 25, 2001 order (filed August 24, 2001), PG&E asserted that "cost of service rates [are] the only legally appropriate baseline given the fact that the California wholesale markets have been found to be unable to yield just and reasonable rates in all hours." *Id.*, at 2. In that Rehearing Request, PG&E similarly states that, "As PG&E has previously stated in these dockets, absent a properly functioning market sellers should be permitted to collect no more than their cost of service, which would include a reasonable return on equity."

PG&E is entitled to no more. As the example set out above illustrates, a lawful cost-of-service rate for the portfolio supporting the PSA is on the order of 2.5 cents/kWh for 2003—roughly half of the rate proposed by PG&E.

C. PG&E ACKNOWLEDGES THAT THE TRUE JUSTIFICATION FOR THE RATES PROPOSED IN THE PSA IS TO SERVICE THE DEBT TO BE INCURRED BY GEN UNDER THE PLAN

Further evidence that the rates proposed in the PSA are justified neither by truly comparable benchmark sales in a competitive environment, nor by any other measure of just and reasonable pricing, is provided in various statements of PG&E's, which reveal the true justification for the proposed rates. For instance, at 41-42 of its Gen 205 application, PG&E states that "it would not be possible for Gen to assume this substantial portion of Exit Financing Debt without the PSA." That is, the rates in the PSA were determined by reference solely to the amount of financing which PG&E anticipates that Gen will incur after taking possession of the generating assets, including DCPP, and by

the cash flow necessary to support that debt. If PG&E thought it could raise additional debt, the rates in the PSA would have been higher. If it had to finance the true market value of the facilities, the rates under the PSA would have to be substantially higher.

In fact, neither the income stream under the PSA nor the PSA itself are necessary for PG&E to emerge from bankruptcy. Nor will PG&E's Plan provide, as PG&E asserts, a quick route out of bankruptcy. The legal infirmities of PG&E's Plan are so extensive (and PG&E apparently so determined to press on with its Plan despite its legal infirmities) that years of litigation over the plan are almost inevitable. Rather, as discussed in part I above, the CPUC has formulated an Alternative Plan, to be outlined in greater detail to the Bankruptcy Court on February 13, 2002, which would enable PG&E to promptly emerge from bankruptcy with a minimum of litigation, without dismantling the company, and without the need to charge PG&E ratepayers the egregious rates proposed in the PSA.

* * * * *

As noted in part I above, the legal infirmities of the PG&E Plan, and their attendant regulatory uncertainties, raise serious doubt about the ultimate approval of that Plan. However, these infirmities and uncertainties also demonstrate that there is no reasonable assurance that Gen will be able to cover the estimated operating costs of DCPP. Thus, Gen cannot by any stretch of the imagination be deemed to satisfy the financial responsibility requirement of the Commission's regulation, at 10 CFR 50.33(f)(2). Moreover, there is a reasonable Alternative Plan, sponsored by the CPUC, under which PG&E will continue to operate DCPP under cost-of-service rates, that <u>does</u>

provide reasonable assurance of more than adequate funding for all of DCPP's plant operational and maintenance-related needs, thereby assuring protection of public health and safety. For all these reasons relating to the lack of financial responsibility of the proposed transferee of DCPP, the Commission should reject PG&E's request for a license transfer.

IV. THE TRANSFER OF DIABLO CANYON OWNERSHIP AND OPERATING LICENSES FROM PG&E TO GEN AND DIABLO WOULD REDUCE CALIFORNIA'S REGULATORY RESPONSIBILITIES OVER NUCLEAR POWER TO THE DETRIMENT OF THE PUBLIC HEALTH, SAFETY AND WELFARE OF THE CITIZENS OF CALIFORNIA.

A. THROUGH ITS REORGANIZATION AND LICENSE TRANSFER SCHEME, PG&E IS SEEKING TO TRUMP THE STATE'S VITAL INTERESTS IN REGULATING UTILITIES

1. California's Basic Interest in Regulating Public Utilities

Approval of PG&E's application to transfer DCPP, as well as other generation facilities, from a state regulated utility to a newly created, largely unregulated LLC would undermine the longstanding relationship between the utility and the ratepayers of California. The contours of this relationship are established in a number of California Public Utilities Code sections that PG&E would like to unilaterally nullify through its reorganization and license transfer scheme.

Under its reorganization scheme, PG&E seeks to evade Public Utilities Code §§ 701, 702, 728, and 761. *See* PG&E's Amended Disclosure Statement ("Amend. Disc. Stmt.") dated December 19, 2001. These sections establish the fundamental relationship between the State of California and its regulated public utilities. Section 701 is the basic enabling provision that establishes the Commission's power to regulate public utilities. It

provides that "[t]he Commission may supervise and regulate every public utility in the State and may do all things, whether designated in this part or in addition thereto, which are necessary and convenient in that exercise of such power and jurisdiction." Cal. Pub. Util. Code §701. Section 702 requires that every public utility obey and comply with every order, decision or rule of the CPUC. Cal. Pub. Util. Code §702. Section 728 provides that whenever, after a hearing, the CPUC finds that rates or classifications set by a public utility are unjust and unlawful, the CPUC shall determine and fix reasonable rates to be observed by the utility. Cal Pub. Util. Code §728. Section 761 provides that whenever, after a hearing, the CPUC finds that any other aspect of a public utility's business is unjust, unreasonable, or otherwise contrary to the public interest, the CPUC shall determine the proper course of conduct for the utility, and order the utility to perform accordingly. Cal. Pub. Util. Code §761.

These four statutes establish the core powers of the CPUC as a regulator. The State of California's interest in enforcing them is, thus, synonymous with its interest in the regulation of public utilities itself. PG&E is using the Bankruptcy Court, the NRC and FERC to dodge its responsibilities under these code provisions. The attempt to transfer its substantial generation assets, particularly DCPP, from this regulated utility to an unregulated LLC is a direct attack on the authority of the State of California, in its sovereign capacity as a government and a regulator, to regulate electrical utilities in the interest of the health and safety of the citizens of California.

2. California's Interest in Ensuring Universal Service and Fair and Just Utility Rates

Through its reorganization and license transfer scheme, PG&E also seeks to escape from its responsibilities under Public Utilities Code Sections 451 and 453. (Amend. Disc. Stmt., at 129). Section 451 establishes the fundamental "duty to serve" obligation on the part of a public utility to serve all of the needs of its customers within its designated area of operation. Cal. Pub. Util. Code §451. Section 451 also establishes the rule that all rates or charges demanded by a public utility for any service rendered or commodity furnished shall be just and reasonable. *Id.* Section 453 provides that all such rates and charges must be set on a non-discriminatory basis, without any unreasonable difference in rates between customers, localities, or classes of service. Cal. Pub. Util. Code § 453.

If Sections 701, 702, 728, and 761 set forth the basic powers of the CPUC and the relationship between the State and its regulated public utilities, Sections 451 and 453 represent the basic purpose of public utility regulation. Without its ability to enforce the utilities' basic obligation to provide electric service to every California customer on a fair and non-discriminatory basis, the State's ability to guarantee this essential right would be eviscerated. *See* Cal. Pub. Util. Code §739.

3. California's Interest in Protecting Financial Integrity and Dedication of Service

PG&E also seeks to shirk its duties under California Public Utilities Code Sections 701.5, 816-830, 845, 851, 852, and 854 by transferring the Diablo Canyon ownership and operating licenses. (Amend. Disc. Stmt., at 130.) These laws provide that a public utility may not enter

into certain transactions that affect its ownership and control, financial integrity, or ability to carry out its functions without prior review and approval by the CPUC. Cal. Pub. Util. Code §§ 701.5, 816-830, 845, 851, 852, 854. The purpose of these sections is to ensure that regulated public utilities do not enter into transactions that undermine their ability to serve their customers. Section 851, for example, prevents a utility from disposing of property useful in the performance of its duty to serve the public without the prior approval of the CPUC, to ensure that a public utility does not jeopardize the public health and welfare by rendering itself unable to serve. Cal. Pub. Util. Code § 851.

As a regulated public monopoly, PG&E does not have the same freedom with its property and operations as a purely private company. In exchange, PG&E enjoys the considerable advantages of being a public monopoly. The State of California has a strong interest in ensuring that its public utilities remain financially sound and in the position to satisfy their obligations to serve their designated service areas. The Legislature determined that the above kinds of transactions have the potential to affect a utility's ability to perform its duties. Thus, the Legislature directed the CPUC to review all such transactions to ensure that they do not have a detrimental impact upon a utility's ability to serve.

Furthermore, California has a strong interest in conditioning any public utility transaction with the potential to affect the environment upon the performance of a CEQA environmental review. *See* Cal. Pub. Res. Code § 21000, *et. seq*. Only by weighing the environmental impacts of a proposed action before it is taken can the State protect its environment and inhabitants from unnecessary harm.

In attempting to bypass the CPUC's review obligation through a bankruptcy

reorganization and license transfer, PG&E attacks the State's basic power to protect the public against the danger that a utility will fail to carry out its duties, or the danger that a proposed utility transaction will have adverse impacts upon the environment.

4. California's Interest in Preventing the Loss of In-State Generation Facilities

PG&E also seeks to dodge the mandates of Public Utilities Code Section 377. (Amend. Disc. Stmt., at 129.) Prior to January 2001, that section provided that, after market valuation, an electrical utility's generation assets would become eligible for deregulation. In the midst of the State's energy crisis, however, the government feared that California electrical utilities might sell or dispose of generation assets to third parties not obligated to serve California ratepayers and not subject to regulation by the Commission.

In January 2001, the California Legislature passed AB1X 6, amending Section 377 to prohibit any public utility from disposing of any generation facilities before January 1, 2006. *See,* California Statutes of 2001, chapter 2. As the Legislature explained in adopting AB1X 6 to take effect immediately as an urgency statute, it amended Section 377 "to ensure that public utility generation assets remain dedicated to service for the benefit of California ratepayers, and are not deregulated as a consequence of market valuation, without appropriate review and authorization of the Public Utilities Commission pursuant to Section 851 of the Public Utilities Code." *Id.*, Sec. 5.

In seeking to thwart Section 377's moratorium, PG&E is using the Bankruptcy Court, the NRC and FERC in an attempt to reverse the California Legislature's recent sovereign determination, during a time of crisis, that it is essential to public health and

safety that all electrical generation assets located in California remain dedicated to service for the benefit of the people of California. Following the proposed license transfer, Diablo would have no such obligation to the citizens of California.

5. California's Interest in Preventing Improper Inter-Company Transactions

Under the reorganization and license transfer scheme, PG&E also seeks to avoid the application of California Public Utility Code Sections 797 and 798 and the CPUC's Affiliate Transaction Rules. (Amend. Disc. Stmt., at 130-31.) Section 797 provides that the Commission shall periodically audit all significant transactions between a public utility and its subsidiaries or affiliates. *See* Cal. Pub. Util. Code § 797. Section 798 provides for civil penalties where the Commission determines that a utility has willfully made an imprudent payment to, or received a less than reasonable payment from, a subsidiary or affiliate. *See* Cal. Pub. Util. Code § 798. The Affiliate Transaction Rules provide a comprehensive code governing the relationship between California's energy utilities and certain of their affiliates. These Rules set forth rules of nondiscrimination and disclosure and separation standards. They also address to what extent a utility should be required to have its non-regulated or potentially competitive activities conducted by its affiliate. *See* CPUC Decision No. 98-08-035, 1998 Cal. PUC LEXIS 594, *2 (August 8, 1998).

The State has an obvious and strong interest in limiting the scope of the monopolies it grants to public utilities in exchange for the utilities' undertaking to serve. These provisions and rules prevent a public utility from abusing its non-arm's length relationship with subsidiaries and affiliates in competition, and otherwise acting to the detriment of the public. In short, these

rules ensure that the considerable benefits that flow from being a regulated public monopoly are properly concentrated in that "regulated" monopoly, and not inappropriately transferred to or otherwise enjoyed by private, unregulated affiliates of that monopoly, which would not be subject to the same regulatory restrictions.

6. California's Interest in Preventing the Misuse of the Holding Company Structure

In Decisions Nos. 96-11-017 and 99-04-068, the CPUC first approved a transaction in which PG&E became a wholly owned subsidiary of a utility holding company. *See* CPUC Decision No. 96-11-017, 1996 Cal. PUC LEXIS 1141 (November 6, 1996). The CPUC later approved a second transaction in which a major subsidiary of the regulated utility, through which it conducted most of its business, became a subsidiary of the parent. *See* CPUC Decision No. 99-04-068, 1999 Cal. PUC LEXIS 242 (April 22, 1999).

In approving these transactions, the CPUC ordered PG&E to continue to comply with its obligations under the Public Utilities Code, including providing appropriate reports to the CPUC, providing the CPUC with access to the corporate books and records, paying dividends only on the basis of a ratepayer interest standard, rather than when it might be in the interest of an affiliate, and properly reporting transactions with affiliates. *See* Decision No. 99-04-068, 1999 Cal. PUC LEXIS at *140-141. As a condition of this approval, PG&E agreed not to abuse the holding company structure as a means to evade its obligations under the Public Utilities Code, and agreed not to abuse the structure to enter into improper self-dealing transactions and cross-subsidize unregulated lines of business. *Id.*

The CPUC imposed these conditions to prevent PG&E from defeating regulation through

a purely formal change in corporate organization. In claiming that these conditions imposed by the CPUC are invalidated due to its bankruptcy filing, PG&E signals its intent to employ the holding company structure as a means to escape its obligations under the California Public Utilities Code. As was amply discussed in Section III above, the new holding company structure created by this reorganization is ripe for abuse.

7. California's Interest in Requiring Utilities to Share Gains On Sale with Ratepayers

PG&E has claimed that the CPUC's "gain-on-sale" rules would be preempted by a Confirmation Order of the Bankruptcy Court. (Amend. Disc. Stmt., at 130.) Generally, these rules establish that gain on the sale of utility properties must be allocated between the shareholders of the utility and the ratepayers, in the form of an offset to the rate base.

Because public utilities operate with ratepayer funds, for the benefit of the ratepayers, the CPUC has determined that ratepayers are entitled to share the benefit of the sale of utility property. The CPUC adopted these rules to encourage utilities to maximize the value of utility assets, while at the same time giving ratepayers the greatest possible reduction in the rate base. California ratepayers have an obvious economic stake in an asset as valuable as the DCPP. Thus, the CPUC's gain-on-sale rules assure that the ratepayers receive an adequate return on the long-term investment they have paid for through rates, and that the property's value is not distributed to holding companies and private shareholders only.

B. STATE REGULATION HAS SIGNIFICANT ADVANTAGES OVER FEDERAL REGULATION

With its reorganization and license transfer scheme, PG&E seeks to transfer its crown jewels from the utility, permanently removing major generating assets from CPUC regulation. Removing state oversight of DCPP is not in best interest of Californians. Under PG&E's proposed scheme, oversight over the rates charged for power generated by the plant would pass from the CPUC to FERC, which oversees wholesale transactions. However, FERC's oversight over the proposed 12-year wholesale power purchase agreement between the proposed Gen and PG&E is insufficient to protect the interests of California ratepayers. State oversight is additionally necessary to handle the many other responsibilities relating to energy generation by a facility such as DCPP.

Ultimately, any regulatory regime exists for the benefit of the public. Here, the residents of California can best be served by local regulations by the CPUC. In a state with such a large population and economy, the regulatory oversight of energy matters necessarily involves considering the rights and interests of many diverse individuals, consumer groups, commercial entities, municipalities, regional districts, other public utilities, and a host of marketing and shipper interests. For one thing, unlike FERC, the CPUC provides for local public hearings, not just in large cities around the State, but also in smaller suburban and rural communities. These hearings allow the average customers of public utilities to communicate their recommendations and objections, based on real-life experiences with their public utilities. Many of the parties and stakeholder groups who appear before the CPUC would almost certainly be unable to participate at FERC,

which holds its hearings in Washington, D.C. and does not address the type of local regulatory concerns, and the health and safety of California citizens, that the CPUC routinely deals with.

Furthermore, in formal proceedings before the CPUC, many cities, consumer groups, irrigation districts, and individuals have the realistic opportunity to participate as active parties. By statute, interveners who contribute to the outcome of the proceeding can receive compensation. *See* Cal Pub. Util. Code §§ 1801, *et seq*. In this way, customers or customer groups can afford, for example, to hire expert witnesses and generally have the means to advocate their views and protect their interests. This important element of the CPUC's regulation of PG&E, as well as the other public utilities of the state, would be lost with respect to an extremely large part of the costs that are calculated into rates, and with respect to the administration of safety and reliability standards that directly involve the public welfare. Under FERC regulations and procedures, only those who can afford to travel to Washington, D.C. (where the FERC exclusively resides) and only those who pay for their own time and expert witnesses would be able to participate in setting rates and in adopting the rules for services that affect their personal lives as well as the economies of their communities. In such cases, these hearing may be without the voices of individuals and consumer groups that directly represent the public interest.

V. PUBLIC SAFETY AND WELFARE ARE THREATENED BY THE PROPOSED LICENSE TRANSFER

Such local concerns are particularly relevant in a post September 11th country where citizens are anxious about state infrastructure reliability and safety, particularly regarding potential terrorist targets such as nuclear power plants. Just this past Friday, a front-page headline in the local Oakland Tribune newspaper read:

> **New Terror Attacks on U.S. Predicted**
> **Nuclear reactor seen as possible target**

See Exhibit H, which is a copy of the newspaper article under this headline clipped from Oakland Tribune of February 1, 2002.

The attached article speaks for itself. According to Secretary of Defense Donald Rumsfeld, nuclear power plant safety is now a fundamental matter of national security, and the lives of millions of Americans are at stake. In the vicinity of DCPP, the lives of over a hundred thousand Californians are at stake.

Given its mission to protect public health and safety, the NRC most certainly should not approve a license transfer, such as the one at issue in this proceeding, in which important safeguards to public health and safety will be lost as a result of the deprivation of concurrent state jurisdiction over an NRC-regulated facility. The task of protecting public safety and national security does not fall to the federal government alone. Since DCPP was licensed in the 1980's, the CPUC the NRC have worked in tandem to assure the safety and reliability of that facility.

In the wake of September 11th, it would be a dereliction of its public duty for the

NRC to dissolve the fruitful and beneficial collaboration of state and federal agencies in overseeing the safety and reliability of DCPP. And yet, as astonishing and unacceptable as its implications are, in this Application, PG&E asks the NRC to dismiss the State of California from any further responsibility to help the NRC oversee the public safety related aspects of the operation of DCPP. Such a dismissal would unquestionably harm public health and safety and would certainly constitute a dereliction by the NRC of its duty to the public and, more broadly, to help assure national security in connection with the operation of nuclear power plants.

A. FINANCIAL ASPECTS

Several critical financial-related public safety and security issues arise in connection with the proposed transfer of the DCPP license from PG&E to Diablo. These issues arise from the transition from a cost-of-service to a market-driven rate base. In the past, nuclear power has required massive public subsidy. Now, however, previously subsidized assets are being transferred out from under public control. This phenomenon poses two major sets of problems:

1. How can nuclear power plants be guaranteed to be run properly at market-based rates? No subsidy plus lower profits equals a recipe for cutting corners. In order to be as competitive as possible in the free market, Diablo will certainly attempt to reduce operating expenses, which, in turn, could very conceivably affect plant safety and reliability, and lead to disaster.

2. The relatively distant relationship between Diablo and its ultimate Parent, PG&E Corporation, seems structured to flow profits from Diablo to Parent while isolating Parent from responsibility for plant operations and safety. Diablo will be held by Gen, which in turn will be held by Newco, which in

> turn will be held by Parent, PG&E Corporation, three levels of limited liability away. In a worst-case scenario, Parent could loot Diablo, blow it out into bankruptcy and then leave the public holding the bag.

A huge safety risk is imposed upon the public by allowing nuclear plants to be run on a profit maximization basis. As is discussed in great detail in part III above, the NRC must accordingly determine whether or not this new entity can properly run DCPP. In this regard, it must be noted that Parent and its subsidiaries have no experience operating nuclear power plants in a deregulated environment. Diablo will operate under a new set of incentives, *i.e.* market ones, and will strive to be unprecedentedly "lean and mean." As a matter of sound public policy, especially in the wake of September 11, should we as a society give control over a nuclear power plant to an entity which may be feeling its way along, and compromising safety and reliability in the process? Public safety and national security dictate that this is too important a matter to allow for unsupervised experimentation.

We can safely presume that, in response to newly relevant market constraints, DCPP will try to downsize its workforce. Even though DCPP will be locked into a 12-year contract to provide power above market rates, the profits realized will not necessarily be applied towards plant maintenance and safety. It will most likely follow the industry trend and not hire the full complement of staff from DCPP's current owner, PG&E. Similarly, DCPP will probably increase its use of overtime. Safety and reliability can only be negatively affected by the likely implementation of such policies.

Moreover, in light of this and other license transfers, the NRC's Revised Reactor

Oversight Process and shift towards "risk based" regulations come at a particularly inopportune moment. They reduce the number of resident inspectors and lessen NRC oversight and on-site support at time of change in ownership and operational priority (*i.e.* merchant rather than regulated cost-of-service based). Not only is the risk to public health and safety evidently increased, but also the failure of any nuclear power plant at this juncture, for operational or financial reasons, could lower market confidence and adversely affect the entire nuclear power industry. Once again, unsupervised experimentation poses unreasonable risks.

Unlike the previous owner, DCPP will have no rate base to support it in time of financial need. The proposed license transfer lacks any adequate assurances of Diablo's ability and financial wherewithal to assure safe operation. A dip in the profitability of the plant could therefore compromise public safety.

Furthermore, as Californians have seen during the recent energy crisis, Diablo's profits will flow to the Parent along a one-way pipeline. The manner in which Diablo's limited liability corporation is structured could well inhibit its flexibility to react quickly to unanticipated problems. Diablo, as a nested LLC, will provide a source of profit to Parent in good times, but will be forced to stand on its own when profits go negative. Accordingly, if Diablo is to acquire the license for DCPP, we must be sure that it is capable of anticipating and meeting maintenance and decommissioning costs. Otherwise, in the event of a crisis or prolonged period of unstable or negative profits, the LLC structure will allow the holding company to bankrupt Diablo and avoid financial responsibility. We have already seen such a scenario realized in the current PG&E

bankruptcy case.

B. PUBLIC SAFETY ASPECTS

Finally, the proposed license transfer would remove a significant level of public safety oversight from DCPP simply by taking ownership out of the hands of PG&E. If PG&E is successful in persuading the Bankruptcy Court to accept its proposed bankruptcy reorganization Plan, DCPP will no longer fall under California regulation. This would not only remove the CPUC from its oversight role, but would also spell the death knell of the Diablo Canyon Independent Safety Committee ("DCISC"). The DCISC was established as a part of a settlement agreement arising out of the CPUC's proceedings in connection with its approval of DCPP. This agreement set up the DCISC as an independent safety committee for the purposes of reviewing DCPP's operations with respect to safety, and for recommending changes to improve safety. The agreement further provided that: (1) the DCISC shall have the right to receive certain operating reports and records of Diablo Canyon; (2) the DCISC shall have the right to conduct an annual examination of the Diablo Canyon site and such other supplementary visits to the plant site as it may deem appropriate; and (3) the DCISC is to prepare an annual report, and such interim reports as may be appropriate, which shall include any recommendations of the Committee.

The detailed nature of the review that the DCISC conducts, and the great value of that review both for public health and safety, for national security, and as a crucial adjunct to the NRC's own oversight responsibility, can best be demonstrated by a review of the thorough and detailed nature of the DCISC's Annual Reports. Accordingly, a copy

of the most recent such Annual Report, covering July 1, 2000 through June 30, 2001, and approved on October 17, 2001, is attached hereto as Exhibit I. Although this Report is voluminous, it evidences a high seriousness of purpose and a profound depth of technical expertise. Indeed, one of the current members of the DCISC, Dr. E. Gail DePlanque, is a former NRC Commissioner.

It would be a shame and, again, a dereliction of the NRC's public responsibilities, to approve a proposed license transfer that would have the effect of eliminating a public oversight body that has done such a commendable job in dovetailing with, and supplementing, the Commission's own nuclear power plant safety oversight jurisdiction. Given the urgent need since September 11th for nuclear power plant safety to be a major national priority, groups like the DCISC should be encouraged and supported, not overlooked and dismissed. For this important public policy and national security reason alone, the NRC should reject PG&E's application in this matter.

VI. CONCLUSION

For the foregoing reasons, the CPUC respectfully requests that the NRC grant its petition for leave to intervene in this matter, and grant its motion to dismiss the Application on file in this matter as premature. In the alternative, CPUC requests that the NRC issue an order holding any proceedings in this matter in abeyance until the all legal issues relating to the possible preemption of state authority raised in the Bankruptcy Court proceeding have been fully addressed and resolved. Finally, if and when the NRC does moves forward on this matter, the CPUC requests the Commission to hold a substantive subpart G hearing pursuant to 10 C.F.R. §2.1329(b), due to the special

circumstances concerning the subject of the hearing.

February 5, 2002

Respectfully submitted,

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EXHIBIT A

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UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF CALIFORNIA
SAN FRANCISCO DIVISION

In re	Case No. 01-30923 DM
PACIFIC GAS AND ELECTRIC COMPANY, a California corporation, Debtor.	Chapter 11 Case
Federal I.D. No. 94-0742640	**CALIFORNIA PUBLIC UTILITIES COMMISSION'S OBJECTION TO PROPOSED DISCLOSURE STATEMENT FOR PLAN OF REORGANIZATION UNDER CHAPTER 11 OF THE BANKRUPTCY CODE FOR PACIFIC GAS AND ELECTRIC COMPANY PROPOSED BY PACIFIC GAS AND ELECTRIC COMPANY AND PG&E CORPORATION** Date: December 19, 2001 Time: 9:30 a.m. Place: 235 Pine Street, 22nd Floor, San Francisco, California

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MISCELLANEOUS

The California Public Utilities Commission (the "CPUC"), a creditor and party in interest in this chapter 11 case, by and through its undersigned counsel, submits this objection (the "Objection") to the proposed Disclosure Statement For Plan of Reorganization Under Chapter 11 of the Bankruptcy Code For Pacific Gas and Electric Company Proposed by Pacific Gas and Electric Company and PG&E Corporation, dated September 20, 2001 (the "Disclosure Statement" or "D.S."). In support of its Objection, the CPUC respectfully represents as follows:

BACKGROUND

On September 20, 2001, Pacific Gas and Electric Company ("PG&E") filed its proposed Plan of Reorganization Under Chapter 11 of the Bankruptcy Code for Pacific Gas and Electric Company (the "Plan") together with its Disclosure Statement.

On October 9, 2001, this Court held a status conference concerning the Disclosure Statement (the "October 9th Status Conference"). At that Status Conference, it was made clear that the Plan and Disclosure Statement were prepared and filed without any negotiation or discussion with many of the key players involved in this case and in the regulation of PG&E's operations, including the CPUC and representatives of the State of California. The CPUC and the State Attorney General's Office also expressed their concern that the myriad requests for declaratory and injunctive relief dispersed throughout the Plan and Disclosure Statement, most of which are aimed at displacing the CPUC's and the State's existing regulatory oversight over PG&E, must be the subject of one or more adversary proceedings.

By Order dated October 10, 2001 (the "October 10th Order"), this Court required that any party in interest that contends that an adversary proceeding is required for the Proponents[1] to obtain any of the relief requested in the Plan must file an objection (the "Adversary Proceeding Objection") by November 6, 2001 setting forth the specific relief sought in the Plan that such party contends can only be obtained by adversary proceeding. This Court further set November 27, 2001 as the last day for filing and serving written objections to the Disclosure Statement and

[1] Capitalized terms used and not defined herein shall have the meanings ascribed to them in the Plan and Disclosure Statement.

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established December 19, 2001 as a "place holder" for a hearing to consider approval of the Disclosure Statement.

Pursuant to the October 10th Order, on November 6, 2001, the CPUC timely filed and served its Adversary Proceeding Objection, which is incorporated herein. The CPUC now submits this Objection to PG&E's Disclosure Statement.

PRELIMINARY STATEMENT

Through its Plan and Disclosure Statement PG&E seeks to affect a regulatory jailbreak unprecedented in scope in bankruptcy annals. Under the guise of section 1123(a)(5) of the Bankruptcy Code and through a misapplication of the debtor protection provisions of chapter 11, PG&E seeks sweeping preemptive relief primarily in the form of no fewer than fifteen affirmative declaratory and injunctive rulings, each designed to permanently dislocate various state and local laws and regulations affecting PG&E's operation of its public utility.[2] PG&E's Plan is concerned only secondarily with adjusting debtor-creditor relations and restoring its utility operations to financial health. To be sure, if those were PG&E's primary concerns, then it would have proposed a much more straightforward reorganization strategy.

PG&E has as its own agenda an escape from CPUC and State regulation. From the outset of this case it has been clear that PG&E seeks to employ this Court as a super-legislature. It first tried in its adversary proceeding against the CPUC where it attempted (unsuccessfully) to overturn portions of the CPUC's March 27th Order.[3] Its Plan and Disclosure Statement constitute more of the same. As with its earlier case against the CPUC, its current scheme is deeply flawed on many levels – constitutional and bankruptcy alike. Such flaws make approval of PG&E's Disclosure Statement at this stage imprudent.

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[2] *See* CPUC's Adversary Proceeding Objection (Docket No. 3104), at 4-5, for a brief description of such requests for declaratory and injunctive relief.

[3] *Southern Cal. Edison Co.*, 2001 WL 327151 (Cal. P.U.C.) 207 P.U.R. 4th 261 (Mar. 27, 2001) (int. opinion re: proposed rate increases) (the "March 27th Order).

The fundamental problem in approving PG&E's Disclosure Statement is that it describes a Plan that is unconfirmable. As demonstrated below, the Plan fails to satisfy certain plan confirmation standards, including those contained in sections 1129(a)(1), (3), (6) and (11) of title 11 of the United States Code, 11 U.S.C. §§ 101 et seq. (the "Bankruptcy Code"), for the following reasons:

- The Plan may not comply with the Bankruptcy Code, as required by section 1129(a)(1), because it fails to contain adequate means for its implementation, a requirement under section 1123(a)(5) of the Bankruptcy Code. The CPUC recognizes that a conclusive determination of this issue necessarily must await the outcome of the adversary proceeding(s) PG&E must commence to obtain the declaratory and injunctive relief it seeks. But approval of the Disclosure Statement at this stage is, at best, premature.
- The Plan has not been proposed in good faith, as required by section 1129(a)(3), because it is inconsistent with the purposes and objectives of the Bankruptcy Code.
- The Plan may provide for hidden rate increases without CPUC approval, in violation of section 1129(a)(6) of the Bankruptcy Code.
- The Plan may not be feasible, as required by section 1129(a)(11). The Plan is predicated entirely upon PG&E's receipt of favorable rulings on many of its requests for declaratory and injunctive relief, as well as favorable outcomes at the FERC, SEC and NRC. Until PG&E obtains such rulings, including by way of one or more adversary proceeding(s), a feasibility determination is impossible.

Where, as here, a disclosure statement describes a Plan that is unconfirmable, the law is clear – such disclosure statement should not be approved.

Approval of PG&E's Disclosure Statement now would place the proverbial confirmation cart before the horse. The Court should first determine whether the relief PG&E seeks is lawful. There is sufficient uncertainty surrounding the lawfulness of PG&E's Plan to warrant such an approach. To proceed otherwise may result in the waste of huge amounts of estate and judicial resources.

Yet, even if this Court disagrees that approval now is premature, the Disclosure Statement still should not be approved. Styled as a complaint against the CPUC and the State of California, the Disclosure Statement lacks the objectivity required for its dissemination to creditors. The Disclosure Statement is riddled with half-truths, misstatements and omissions.

Also, in many instances it leaves unanswered more questions than it answers. Thus, at a minimum, the Disclosure Statement must be substantially amended prior to its approval by the Court.

For these reasons approval of the Disclosure Statement is unwarranted and inappropriate.

ARGUMENT

I.

PG&E'S DISCLOSURE STATEMENT DESCRIBES A PLAN THAT IS UNCONFIRMABLE AS A MATTER OF LAW[4]

This Court should not approve PG&E's Disclosure Statement because it describes a nonconfirmable Plan. The law is well settled in this Circuit and elsewhere that a disclosure statement that describes a nonconfirmable plan is incapable of being approved. *In re Silberkraus*, 253 B.R. 890, 899 (Bankr. C.D. Cal. 2000) ("There are numerous decisions which hold that where a plan is on its face nonconfirmable, as a matter of law, it is appropriate for the court to deny approval of the disclosure statement describing the nonconfirmable plan.") (citi *In re United States Brass Corp.*, 194 B.R. 420 (Bankr. E.D. Tex. 1996); *In re Spanish Lake Assoc.*, 92 B.R. 875, 877 (Bankr. E.D. Mo. 1988); *In re Pecht*, 57 B.R. 137, 139 (Bankr. E.D. Va. 1986); *In re Century Investment Fund VIII Ltd. Partnership*, 114 B.R. 1003 (Bankr. E.D. Wis. 1990)); *In re Main Street AC, Inc.*, 234 B.R. 771, 776 (Bankr. N.D. Cal. 1999) (denying approval of disclosure statement where plan whose principal purpose was avoidance of application of securities laws was unconfirmable); *In re 266 Washington Assoc's.*, 141 B.R. 275, 288 (Bankr. E.D.N.Y. 1992), *aff'd* 147 B.R. 827 (E.D.N.Y. 1992) (same).[5] To hold otherwise,

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[4] At the outset, the CPUC reserves the right to make these and other objections to the Plan's confirmability in connection with any confirmation hearing that may be scheduled by this Court.

[5] This Court has acknowledged as much. *See* Transcript of October 9th Status Conference at 37 (responding to the U.S. Trustee's position that the Court should not send out a disclosure statement that describes a flawed plan; "If it's – on its face it's unconfirmable, I agree with you of course. The law is clear on that . . . .").

would result in a waste of time and resources and burden the estate with unnecessary expense. *In re Eastern Maine Elec. Coop., Inc.*, 125 B.R. 329, 333 (Bankr. D. Me. 1991) ("[U]ndertaking the burden and expense of plan distribution and vote solicitation is unwise and inappropriate if the proposed plan could never legally be confirmed."); *In re Valrico Square Ltd. P'ship*, 113 B.R. 794, 796 (Bankr. S.D. Fla. 1990) ("Soliciting votes and seeking court approval on a clearly fruitless venture is a waste of the time of the Court and the parties.").

As described more fully below, PG&E's Plan is unconfirmable because it fails to satisfy the confirmation standards set forth in sections 1129(a)(1), (3), (6) and (11) of the Bankruptcy Code. These Plan infirmities render PG&E's Disclosure Statement incapable of being approved.

A. PG&E's Plan Violates Section 1129(a)(1) of the Bankruptcy Code.

Section 1129(a)(1) of the Bankruptcy Code requires a plan of reorganization to comply "with the applicable provisions of [title 11]." 11 U.S.C. § 1129(a)(1); *Resorts Int'l* v. *Lowenschuss (In re Lowenschuss)*, 67 F.3d 1394, 1401 (9th Cir. 1995). ("The bankruptcy court lacks the power to confirm plans of reorganization which do not comply with applicable provisions of the Bankruptcy Code."). "An examination of the Legislative History of [section 1129(a)(1)] reveals that although its scope is certainly broad, the provisions it was most directly aimed at were Sections 1122 and 1123." *In re S&W Enter.*, 37 B.R. 153, 158 (Bankr. N.D. Ill. 1984).

PG&E's Plan violates section 1123(a)(5) of the Bankruptcy Code by failing to provide adequate means for its implementation. *See* 11 U.S.C. § 1123(a)(5).[6] As noted above and in the

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[6] Section 1123(a)(5) provides that

> (a) [n]otwitstanding any otherwise applicable nonbankruptcy law, a plan shall — (5) provide adequate means for the plan's implementation such as—
>
> (A) retention by the debtor of all or any part of the property of the estate;
>
> (B) transfer of all or any part of the property of the estate to one or more entities, whether organized before or after the confirmation of such plan;

0080

CPUC's Adversary Proceeding Objection, PG&E's Plan is predicated upon its obtaining no fewer than fifteen favorable declaratory and injunctive rulings, each designed to displace portions of the CPUC's and the State of California's century-old regulatory authority over PG&E's operations.[7] Where, as here, a plan is largely predicated on one or more favorable judicial rulings, courts have held that the plan fails to satisfy section 1123(a)(5). *See In re Yates Dev., Inc.*, 258 B.R. 36, 43 (Bankr. M.D. Fla. 2000) (holding that plan predicated on favorable appellate court ruling impermissibly shifted the risk of delay in plan effectiveness from the debtor to creditors); *In re Sunflower Racing, Inc.*, 219 B.R. 587, 604-05 (Bankr. D. Kan. 1998) *aff'd.* 226 B.R. 673 (D. Kan. 1998) (holding that plan that is predicated on the occurrence of multiple events whose outcome is uncertain is infeasible).

> (C) merger or consolidation of the debtor with one or more persons;
>
> (D) sale of all or any part of the property of the estate, either subject to or free of any lien, or the distribution of all or any part of the property of the estate among those having an interest in such property of the estate;
>
> (E) satisfaction or modification of any lien;
>
> (F) cancellation or modification of any indenture or similar instrument;
>
> (G) curing or waiving of any default;
>
> (H) extension of a maturity date or a change in an interest rate or other term of outstanding securities;
>
> (I) amendment of the debtor's charter; or
>
> (J) issuance of securities of the debtor, or of any entity referred to in subparagraph (B) or (C) of this paragraph, for cash, for property, for existing securities, or in exchange for claims or interests, or for any other appropriate purpose.

11 U.S.C. § 1123(a)(5).

[7] *See* Plan Art. 8.1 (listing many of the declaratory and injunctive requests as conditions precedent to confirmation); D.S. at 147-48 (noting that the Bankruptcy Court's refusal to approve the Reorganized Debtor's conditions for its assumption of the net short position would jeopardize PG&E's financial viability rendering it "unable to consummate the Plan").

That same result is particularly warranted here given that the relief PG&E seeks is unlawful. PG&E bases its claim for such relief on its unprecedented and incredibly sweeping interpretation of section 1123 of the Bankruptcy Code.[8] However, the preemptive relief PG&E seeks is not available under section 1123, nor under any other provision of the Bankruptcy Code for that matter. In addition, PG&E is barred from obtaining the relief it seeks against the CPUC or the State under the Eleventh Amendment to the U.S. Constitution and related principles of sovereign immunity. These legal infirmities render the Plan incapable of being implemented, as required under section 1123(a)(5), which, in turn, renders the Plan unconfirmable.[9]

However, this Court need not, and indeed should not, rule on the Plan's confirmability under sections 1129(a)(1) or (11) in the context of a Disclosure Statement hearing. Rather, such rulings must await the Court's separate determination of the lawfulness of the declaratory, injunctive and other preemptive relief PG&E seeks – relief that is the linchpin of PG&E's Plan and which the CPUC submits may only be sought through PG&E's commencement of one or more adversary proceeding(s) against the CPUC and others whose rights PG&E seeks to affect. *See generally*, CPUC's Adversary Proceeding Objection (Docket No. 3104).[10] Only at that point can interested parties be relatively certain whether PG&E's Plan complies with section

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[8] *See, e.g.*, D.S. at 3 ("Pursuant to section 1123(a) of the Bankruptcy Code, the Bankruptcy Code preempts any otherwise applicable non-bankruptcy law that may be contrary to its provisions.").

[9] The Plan is likewise infeasible and, thus, violates section 1129(a)(11) as well. Section 1129(a)(11) requires that a plan may only be confirmed if "[c]onfirmation of the plan is not likely to be followed by the liquidation, or the need for further financial reorganization, of the debtor or any successor to the debtor under the plan." 11 U.S.C. § 1129(a)(11). By its own admission, certain of the declaratory and injunctive relief PG&E seeks "is a critical component of the overall feasibility of the Plan." D.S. at 147-48 (discussing PG&E's need for this Court to declare that PG&E need not resume procurement of its net open position until certain PG&E-imposed criteria have been satisfied). *See* Objection, *infra* at pp. 14-15, for a further discussion of the CPUC's feasibility concerns.

[10] That the Plan itself purports to provide for such declaratory and injunctive relief is violative of section 1129(a)(1) of the Bankruptcy Code. Rule 7001 of the Bankruptcy Rules requires that such relief must be obtained by adversary proceeding. *See* Fed. R. Bankr. P. 7001(7), (9); CPUC's Adversary Proceeding Objection at 8-12. By failing to comply with Bankruptcy Rule 7001 PG&E's Plan cannot comply with section 1129(a)(1).

1129(a)(1) or (11) of the Bankruptcy Code and is otherwise confirmable. Until then, however, approval and dissemination of PG&E's Disclosure Statement would be premature and could result in a waste of estate and judicial resources.

Accordingly, because the adversary proceeding(s) likely will resolve a number of critical issues directed at the Plan's confirmability, approval and dissemination of the Disclosure Statement should await their outcome.[11]

B. <u>PG&E's Plan Violates Section 1129(a)(3) of the Bankruptcy Code.</u>

PG&E's Plan has not been submitted in good faith as required by section 1129(a)(3) of the Bankruptcy Code. Under that section, a prerequisite to confirmation is that "[t]he plan has been proposed in good faith and not by any means forbidden by law." 11 U.S.C. § 1129(a)(3). To satisfy section 1129(a)(3)'s "good faith" requirement, "a Plan must be intended to achieve a result consistent with the objectives of the Bankruptcy Code." *Ryan* v. *Loui* (*In re Corey*), 892 F.2d 829, 835 (9th Cir. 1989); *Pac. First Bank* v. *Boulders on the River* (*In re Boulders on the River*), 164 B.R. 99, 103 (B.A.P. 9th Cir. 1994). Whether a plan is proposed in "good faith" depends upon "the totality of the circumstances" surrounding the debtor's chapter 11 case. *See Stolrow v. Stolrow's, Inc. (In re Stolrow's Inc.)*, 84 B.R. 167, 172 (9th Cir. B.A.P. 1988).

In addition to being consistent with the Bankruptcy Code's purposes and objectives, to satisfy the "good faith" requirement the Plan and Disclosure Statement must not be intentionally

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[11] PG&E's legal entitlement to the declaratory, injunctive and other preemptive relief it seeks is ripe for determination right now. The doctrine of ripeness "prevents courts from deciding theoretical or abstract questions that do not yet have a concrete impact on the parties." *Shell Oil Co.* v. *City of Santa Monica*, 830 F.2d 1052, 1061 (9th Cir. 1987), *cert. denied*, 487 U.S. 1235 (1988). Ripeness requires that a court "'look at the facts as they exist today in evaluating whether the controversy . . . is sufficiently concrete to warrant [judicial] intervention.'" *Id.* at 1062 (quoting *Assiniboine & Sioux Tribes* v. *Bd. of Oil & Gas Conservation*, 792 F.2d 782, 788 (9th Cir. 1986)).

PG&E's filing of its Plan clearly raises the preemption issue and puts squarely before this Court each of its approximately fifteen requests for declaratory and injunctive relief. The CPUC and others have made no secret of our (and their) opposition to the relief PG&E seeks and our (and their) belief that such relief is unlawful. The issues have been joined and it is appropriate to litigate them now, prior to approval of the Disclosure Statement. No purpose is served by delay.

misleading or incomplete. *Big Shanty Land Corp.* v. *Comer Prop., Inc.*, 61 B.R. 272, 281 (N.D. Ga. 1985) (noting that where disclosure is intentionally misleading or incomplete "there is sufficient precedent for resting a finding of bad faith") (citing *American United Mutual Insurance Co.* v. *City of Avon Park*, 311 U.S. 138 (1940); *Barnes* v. *Whelan*, 689 F.2d 193 (D.C. Cir. 1982); *In re Goeb*, 675 F.2d 1386, 1390 n.9 (9th Cir. 1982)).

PG&E's Plan and Disclosure Statement are both inconsistent with the Bankruptcy Code's purposes and objectives and are intentionally misleading.

(a) PG&E's Scheme to Escape from State Regulation is Inconsistent with the Bankruptcy Code's Purposes and Objectives

Though masked in debtor-creditor garb, the focus of PG&E's Plan is its desired escape from state regulation, an unattainable objective long sought by PG&E. Indeed, it may well be the primary motivation for PG&E's decision to walk away from the negotiating table and go its own way in bankruptcy. Surely, a less draconian approach exists for PG&E to satisfy its debts and repay creditors. But PG&E apparently will not consider alternatives that keep it under CPUC and State regulatory control.

There exists no basis under the Bankruptcy Code for PG&E's attempted use of chapter 11 as a legislative device to displace entire regulatory schemes. To the contrary, numerous Bankruptcy Code provisions evince Congressional respect for state and local laws and regulations. *See e.g.*, 11 U.S.C. § 362(b)(4) ("police and regulatory power" exception to the automatic stay); § 541 (property rights determined by reference to state law); 28 U.S.C. § 959(b) (requiring debtors in possession to operate their businesses in accordance with state laws). If PG&E desires to "FERC itself" by transferring vast amounts of property from state to federal control, it must seek the approval of appropriate state and federal legislators and regulators. Such relief is not available to it under chapter 11.

PG&E is not acting in good faith by attempting to use the plan process to deregulate itself by shifting significant estate assets beyond state regulation. As a result, its Plan is incapable of satisfying section 1129(a)(3)'s "good faith" requirement and is thus, unconfirmable.

(b) The Disclosure Statement is Misleading

In PG&E's effort to excoriate (unfairly) the CPUC and the State of California and in th process turn creditors against the CPUC and the State and in favor of PG&E's deregulation scheme, PG&E ends up grossly mischaracterizing many of the CPUC's and the State's actions taken prior to and during this case. The result is that the Disclosure Statement is riddled with half-truths and hyperbole and is plainly misleading.

For instance, in Section IV of the Disclosure Statement, captioned "Events Preceding the Commencement of the Chapter 11 Case and Filing of the Plan," PG&E paints an extremely distorted and one-sided picture of the regulatory events preceding its chapter 11 filing. Without responding to each and every misstatement, mischaracterization, distortion or omission (which would take great length), the CPUC will nonetheless, through a few key illustrations, attempt to debunk certain of PG&E's myths:

- **MYTH:** The CPUC and representatives of the State of California failed to address promptly PG&E's financial situation. *See, e.g.*, D.S. at 41-43.

- **FACT:** On the contrary, the CPUC moved quickly. As a regulatory body, the CPUC is required, among other things, to provide due process to the various partie its proceedings and to comport with various statutory and procedural requirements. In many instances, the CPUC accelerated the emergency rate relief proceedings, waived or reduced parties' comment periods and removed procedural barriers that otherwise would have delayed CPUC decisions. The CPUC also aided PG&E in other respects, such as by implementing the State's emergency energy legislation and challenging at the FERC the unjust and unreasonable wholesale electric prices charged to PG&E and seeking refunds therefor.

- **MYTH:** The CPUC hindered PG&E's ability to enter into block forward contracts for the purchase of power to hedge against spikes in market prices. D.S. at 32-34.

- **FACT:** During the first 18 months after the CPUC approved PG&E's participation in the California Power Exchange Corporation's block forward market ("BFM") (July 1999 through December 2000), PG&E utilized only about 35% of its BFM procurement allotment. Though PG&E faults the CPUC for not authorizing its use of hedging instruments earlier, PG&E failed to fully utilize the authority it was given. PG&E claims that the BFM proved to be thinly traded and of limited use for hedging purposes. D.S. at 26. While that may be true, it was due, in large part, to PG&E's and California's other investor-owned utilities' reluctance to commit their demand to the BFM. PG&E would have been afforded significant price protection against the run up of wholesale electric prices that began in May 2000 had it utilized the BFM to a greater extent.

- **MYTH:** The CPUC, consumer groups and policymakers thrust deregulation upon PG&E and California's other investor-owned utilities. D.S. at 28-30.

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- **FACT:** PG&E not only supported passage of AB 1890 in 1996, but claimed credit for its development. For example, in its 1997 annual report, the Parent stated that "our Utility in conjunction with other California electric utilities, the CPUC, state legislators, consumer advocates, and others, developed a transition plan, in the form of state legislation [AB 1890], to position California for the new market environment." *See* 1997 PG&E Corp. Annual Report, at 20-21. It is not surprising that PG&E and its Parent took credit for deregulation in 1997. During the first few years of deregulation PG&E profited handsomely as a result of the artificially high rate freeze and was able to upstream billions of dollars to its Parent. Now, unhappy with the way things turned out, PG&E and its Parent seek only to attribute blame. PG&E cannot have it both ways.

- **MYTH:** The CPUC's audits revealed that PG&E "had accurately portrayed the accounting on which the Debtor had calculated that the rate freeze had ended." D.S. at 48-49.

- **FACT:** The CPUC's audit report contained no such finding. Such a finding would have required the auditors to market value PG&E's assets, which the auditors did not do.

- **MYTH:** "The Debtor was forced to seek relief under Chapter 11 of the Bankruptcy Code in part because of the *unlawful* actions of the State and the CPUC relating to the recovery of transition costs and the filings to timely conclude that the conditions for ending the rate freeze had been satisfied." D.S. at 91 (emphasis added).

- **FACT:** This is an expression of PG&E's opinion; it is not a fact. Neither the State's nor the CPUC's actions have been held to be unlawful. To the contrary, in the only challenge to have been decided, this Court held that the accounting true-up portion of the CPUC's March 27th Order did not violate the Bankruptcy Code's automatic stay.

The Disclosure Statement is misleading in other key respects as well. For example, PG&E represents that Gen's, ETrans' and GTrans' assets will "continue to be regulated to protect the public interest," D.S. at 7, but fails to take account of the vast range of environmental and public interest issues imperiled by PG&E's proposed wholesale transfer of such assets, particularly the hydroelectric and land assets to be transferred to Gen.[12] In addition, PG&E asserts that "[t]he Plan . . . is, in the Proponents' reasoned opinion, the *only* reasonable solution . . . ." D.S. at 54 (emphasis added). The CPUC submits that this is a gross overstatement for at

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[12] For example, the Disclosure Statement fails to address the impact upon California's environment and the public of PG&E's planned swith to the FERC's environmental standards which, in many respects, are less strict than those of the CPUC and the State. The CPUC is concerned that the wholesale transfer of PG&E's transmission and generation assets beyond CPUC and State control could, among other things, negatively impact the State's water flows and water and air quality and result in significant losses of forest, habitat and recreation in PG&E's watershed lands. These and other environmental issues are the subject of an extensive report prepared in connection with PG&E's proceeding before the CPUC to sell its hydroelectric assets. These issues are important and deserve greater mention in the Disclosure Statement.

least two reasons: *first*, PG&E never once approached the CPUC or the State to see if an alternative existed; and *second*, the drastic decline in wholesale power prices during the last few months has left PG&E with "headroom" again, which may provide PG&E and its creditors with viable alternatives.[13] In short, PG&E's Plan is not the "only solution," it merely is PG&E's preferred outcome.

PG&E's intent in unfairly slanting the factual background and other aspects of its Disclosure Statement is clear – it seeks to portray the CPUC and the State as incompetent so that it can curry favor with creditors in support of its deregulation scheme. Essentially, PG&E is telling those voting on the Plan that their only chance to be paid in full is for PG&E to embark upon a regulatory sea change that transfers valuable assets beyond CPUC and State control. That is ludicrous. And, more importantly, it constitutes an abuse of the disclosure process, which is intended to ensure that creditors/voters are presented with objective information that hopefully will inform their decision to accept or reject a plan of reorganization. PG&E's exaggerations and misrepresentations alone merit denial of the Disclosure Statement.[14]

C. <u>PG&E's Plan Violates Section 1129(a)(6) of the Bankruptcy Code</u>.

Despite representations to the contrary in its Disclosure Statement,[15] the CPUC suspects that PG&E's Plan is premised upon a disguised rate increase.[16] Section 1129(a)(6) of the Bankruptcy Code requires as a condition to confirmation that "[a]ny governmental regulatory commission with jurisdiction, after confirmation of the plan, over the rates of the debtor has

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[13] PG&E's Disclosure Statement nowhere mentions "headroom" in electric rates or its record profits in the latest quarter, both of which have been widely reported in the press and PG&E's own SEC filings. Surely, such information is relevant.

[14] In the event that this Court disagrees, then the CPUC requests that, at a minimum, PG&E be required to amend its Disclosure Statement to correct the various misrepresentations contained therein. The CPUC is available to meet and confer with PG&E to craft acceptable alternative language.

[15] *See* D.S. at 6, 69 ("Without raising retail electricity rates above current levels, the Plan provides . . . .).

[16] If the CPUC is wrong, then PG&E should demonstrate why through added disclosure.

approved any rate change provided for in the plan, or such rate change is expressly conditioned on such approval." 11 U.S.C. § 1129(a)(6).[17] PG&E's failure to provide for CPUC approval of any rate increase in its Plan violates section 1129(a)(6) and, as a result, renders PG&E's Plan unconfirmable.

At least two factors inform the CPUC's rate suspicion. The first is that the Plan and Disclosure Statement may be premised upon the assumption that the entire three-cent rate increase ordered by the CPUC on March 27, 2001 belongs to PG&E. Pursuant to the express terms of the March 27th Order, however, a portion of that three-cent rate increase is to be allocated to DWR. March 27th Order at 19 n.4, 27, 56, 64, 67. Thus, if PG&E hopes to keep it all (or any portion that would otherwise belong to DWR), then its electric rates must necessarily increase.[18]

Second, the rates Gen proposes to charge the Reorganized Debtor under the Power Sales Agreement to be entered into between the two exceeds Gen's cost-based rate. Currently, CPUC regulations and State law permit PG&E to charge only cost-based rates. The mark-up above cost provided for in PG&E's Plan is without CPUC consent.

For these reasons, PG&E's Plan is unconfirmable under section 1129(a)(6) of the Bankruptcy Code.

D. <u>PG&E's Plan Violates Section 1129(a)(11)'s Feasibility Requirement.</u>

As noted above, section 1129(a)(11) requires that before a Plan may be confirmed, its proponent must demonstrate that,

> "[c]onfirmation of the plan is not likely to be followed by the liquidation, or the need for further financial reorganization, of the debtor or any successor to the debtor under the plan."

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[17] In its Disclosure Statement, PG&E admits that "[t]he CPUC will continue to have jurisdiction over the Debtor's retail electric and gas distribution assets, rates and services . . . ." D.S. at 7. Accordingly, pursuant to section 1129(a)(6) of the Bankruptcy Code, any rate increase provided for by the Plan requires CPUC approval.

[18] Because the CPUC has not yet allocated the three-cent rate increase among DWR and PG&E it is unclear how PG&E can keep any portion of such increase without CPUC approval.

11 U.S.C. § 1129(a)(11).

Clearly, if PG&E is unable to obtain at least certain of the various declaratory and injunctive rulings and other preemptive relief it seeks, then its Plan will not be feasible. This much PG&E admits in its Disclosure Statement. *See* n. 9, *supra*.

Other feasibility concerns persist as well. For one thing, PG&E's projections for the Reorganized Debtor's operating revenues assume that "[e]lectric annual load growth approximates 2% per year." Exhibit C to D.S. at 3. This assumption, however, is unsupported by historical evidence, which instead shows that electric load growth has been flat, if not declining. If PG&E is wrong, and history is a more accurate barometer of future load growth, then the Reorganized Debtor may experience unanticipated financial pressures.

The CPUC is skeptical of the Reorganized Debtor's survival for another reason as well. Assuming PG&E's Plan is confirmed, the Reorganized Debtor would be stripped of many crown jewels, such as its hydroelectric and transmission assets and any recovery in its Rate Recovery Litigation (all of which would be transferred to its Parent), yet it would remain burdened with many of the liabilities with which it entered bankruptcy (*i.e.*, those that according to PG&E's Plan will survive chapter 11). The CPUC fears that this imbalance in the Reorganized Debtor's remaining assets and liabilities could seriously jeopardize its ability to weather future financial storms. This fear is underscored by PG&E's own financial projections which show that the Reorganized Debtor's current liabilities will exceed its current assets by between approximately $750 – 800 million per year between the years 2002 through 2005. *See* Exhibit C to D.S., Reorganized Debtor Balance Sheet.

For these reasons, the CPUC believes that PG&E's Plan may not satisfy section 1129(a)(11)'s "feasibility" requirement.

II.

PG&E's DISCLOSURE STATEMENT CONTAINS INADEQUATE INFORMATION

Despite its length, PG&E's Disclosure Statement is riddled with inadequacies. Meaningful and accurate disclosure is at the heart of the reorganization process. *Oneida Motor Freight, Inc.* v. *United Jersey Bank*, 848 F.2d 414, 417 (3d Cir. 1988), *cert. denied*, 488 U.S. 967 (1988); *H & L Dev., Inc.* v. *Arvida/JMB Partners (In re H & L Dev., Inc.)*, 178 B.R. 71, 74 (Bankr. E.D. Pa. 1994). Effective disclosure requires the dissemination of "adequate information," *Knupfer* v. *Wolfberg (In re Wolfberg)*, 255 B.R. 879, 883 (B.A.P. 9th Cir. 2000), defined under the Bankruptcy Code to include:

> information of a kind, and in sufficient detail, as far as is reasonably practicable in light of the nature and history of the debtor and the condition of the debtor's books and records, that would enable a hypothetical reasonable investor typical of holders of claims or interests of the relevant class to make an informed judgment about the plan . . . .

11 U.S.C. § 1125(a)(1).

What constitutes adequate information varies from case to case. *Texas Extrusion Corp.* v. *Lockheed Corp. (In re Texas Extrusion Corp.)*, 844 F.2d 1142, 1157 (5th Cir. 1988), *cert. denied*, 488 U.S. 926 (1988); *In re Diversified Investors Fund XVII*, 91 B.R. 559, 560 (Bankr. C.D. Cal. 1988); *In re Reilly*, 71 B.R. 132, 134-35 (Bankr. D. Mont. 1987). As a general rule, however, "[t]he [plan] proponent should be biased towards more disclosure than less." *Official Comm. of Unsecured Creditors* v. *Michelson (In re Michelson)*, 141 B.R. 715, 720 (Bankr. E.D. Cal. 1992). In that vein, courts have established certain minimum disclosure requirements — information that must be contained in every disclosure statement — including the following:

(a) the events leading to the filing of the bankruptcy petition;

(b) a summary of the proposed plan of reorganization;

(c) a description of the available assets and their values;

(d) the condition and performance of the debtor while in chapter 11;

(e) information regarding claims against the estate;

(f) a liquidation analysis setting forth the estimated return that creditors would receive under chapter 7;

(g) the accounting and valuation methods used to produce the financial information in the disclosure statement;

(h) the collectability of any accounts receivable;

(i) any financial information, valuations or pro forma projections that would be relevant to determinations of whether to accept or reject the plan;

(j) information relevant to the risks being taken by the creditors and interest holders;

(k) the actual or projected value that can be obtained from avoidable transfers;

(l) the existence, likelihood and possible success of nonbankruptcy litigation;

(m) the debtor's relationship with its affiliates;

(n) the future management of the debtor;

(o) the source(s) of information stated in the disclosure statement;

(p) the scheduled claims;

(q) the estimated administrative expenses, including attorneys' and accountants' fees;

(r) the debtor's tax attributes; and

(s) the anticipated future of the company.

See, e.g., In re Dakota Rail, Inc., 104 B.R. 138, 142 (Bankr. D. Minn. 1989); *In re Microwave Prod. of Am., Inc.*, 100 B.R. 376, 378 (Bankr. W.D. Tenn. 1989); *Diversified Investors Fund XVII*, 91 B.R. at 560; *Reilly*, 71 B.R. at 134; *In re Jeppson*, 66 B.R. 269, 292. (Bankr. D. Utah 1986).

In this case, PG&E's Disclosure Statement clearly fails to satisfy at least items (c), (g), (j), (k), (l), (m) (n), (o), (q) and (r) of the foregoing list. PG&E's Disclosure Statement is deficient in numerous other respects as well, as described below.

A. <u>The Disclosure Statement Fails to Disclose Claims Against Third Parties.</u>

PG&E's Disclosure Statement fails to identify significant claims PG&E's bankruptcy estate may have against third-parties. The most glaring omissions are claims against the Parent and against generators and others who sold power to PG&E.

(i) Claims against the Parent

PG&E's estate holds certain claims against its Parent which could prove to be a valuable source of recovery for its creditors. The CPUC is aware of at least two types of such claims:[19] (i) claims that the Parent violated the "first priority" rule ordered by the CPUC when it approved PG&E's holding company structure;[20] and (ii) avoidance actions for dividend and other payments made by PG&E to its Parent while PG&E may have been insolvent.[21] Disclosure of these (and other) claims not only is required under the case law cited above, but is essential, for instance, for creditors and others to value the release to be provided to the Parent under Article 11.5(b) of the Plan.[22] Accordingly, PG&E's Disclosure Statement must be amended to include a discussion of the nature and potential value of the claims PG&E's bankruptcy estate may have against the Parent.

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[19] These claims are the subject of a pending CPUC investigation. To the extent other claims exist their disclosure is similarly required.

[20] The "first priority" rule addresses the Parent's obligation to give "first priority" to PG&E's capital requirements to meet its obligations to serve. *Re: Pacific Gas and Elec. Co.*, 1999 WL 589171 (Cal. P.U.C.) 194 P.U.R. 4th 1 (Apr. 22, 1999) (decision approving formation of holding company) at § 6.4. According to the report (the "Audit Report") issued by the auditors retained by the CPUC in December of 2000 to audit PG&E, "[s]ince 1997 [when the holding company was formed, Parent] has not provided cash, credit or other financial assistance or support to PG&E . . . . Historically, cash has flowed in only one direction, from PG&E to [Parent] and then to [PG&E's] unregulated affiliates." *Review of Pacific Gas and Elec. Co. Financial Condition for Cal. Public Utilities Comm'n*, Barrington-Wellesley Group, Inc. (Jan. 30, 2001) at I-5 *available at* www.cpuc.ca.gov/word_pdf/audit/pge_report .pdf. By failing to downstream funds to PG&E during times of need, the Parent violated the "first priority" rule.

[21] The Audit Report further disclosed that "[f]rom 1997 to 1999 PG&E provided [Parent] $4.0 billion in the form of dividends paid and repurchases of stock." *Id.*

[22] Article 11.5(b) of the Plan provides that:

> [a]s of the Effective Date, the Debtor releases the Parent from any and all Causes of Action held by, assertable on behalf of, or derivative from, the Debtor, in any way relating to the Debtor, the Debtor-in-Possession, the Chapter 11 Case, the Plan, negotiations regarding or concerning the Plan, the ownership, management and operation of the Debtor, and any transactions or transfers between the Parent and the Debtor, including but not limited to, any Cause of Action arising under Chapter 5 of the Bankruptcy Code or any state fraudulent conveyance statute.

Plan Art. 11.5(b).

(ii) Generator claims

PG&E must similarly disclose claims, including refund claims pending before the FEF that PG&E may have against generators and others that sold it power at unjust and unreasonable prices.[23] As the Disclosure Statement correctly points out, the FERC has determined that certain electric sales in California since October 2, 2000 are subject to refund. D.S. at 55. The potential total recovery to the State and its three investor-owned public utilities could range from $1 to $9 billion. Despite their significance, PG&E pays these claims mere lip service in its Disclosure Statement. *See* D.S. 54-55. Greater disclosure is required. Specifically, PG&E should, at a minimum, disclose the estimated value of these claims as well as the likelihood and timing of recovering on them and the potential impact of such recoveries on its reorganization.[24] PG&E should be compelled to do the same with respect to any and all other claims it may have against the generators and other power sellers.

B. The Disclosure Statement Insufficiently Discloses the Risks Associated with PG&E's Scheme to Escape State Regulation.

On its face, PG&E's Plan seems like a panacea for PG&E's creditors – recovery in full with interest. However, it is far from certain that PG&E will obtain the various declaratory and injunctive rulings and other preemptive relief necessary for it to confirm its Plan. Indeed, the CPUC believes that such relief is unlawful. Surely, those voting on the Plan are entitled to know just how bumpy a confirmation road lies ahead. Presently, they are offered no clue.

For starters, the Disclosure Statement should inform those voting on the Plan that the preemptive relief PG&E seeks is unprecedented in scope.[25] The CPUC is unaware of any case in

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[23] The CPUC is aware that this may be a sensitive issue for PG&E given the generators' significant representation on the Creditors' Committee and the Creditors' Committee's support of its Plan. Nevertheless, such disclosure is required because claims against the generators constitute significant assets of PG&E's chapter 11 estate.

[24] PG&E's estate has retained outside counsel to investigate and prosecute claims against the generators and PG&E is active in the FERC refund proceedings. As a result, PG&E could easily supply these added disclosures.

[25] Undoubtedly, PG&E and those familiar with bankruptcy lore will quickly point to the *Public Service of New Hampshire* case as precedential value for the relief PG&E seeks. However, the scope of the preemptive relief sought in that case was much narrower than the relief

which a regulated utility succeeded in deregulating itself under a plan of reorganization. Creditors voting on PG&E's Plan should be made aware of this. In addition, creditors should be apprised of the procedural and timing issues associated with the requested relief. Nowhere does the Disclosure Statement mention that to obtain such relief PG&E likely will have to litigate with the CPUC, the State and others every step of the way, including by way of one or more adversary proceedings against multiple defendants. Nor does the Disclosure Statement contain any reference as to how long it may take PG&E to prevail (including appellate proceedings) or how much it may cost. This information is critical to those evaluating whether to accept or reject the Plan. It is one thing for creditors to expect to receive distributions by January 2002; it is quite another to caution that litigation may delay distributions for years.

Finally, PG&E should provide creditors with some insight into the likelihood that it will obtain the various declaratory and injunctive rulings and other preemptive relief it seeks. It is not enough for PG&E simply to state that such relief is available under section 1123(a)(5) of the Bankruptcy Code. That is a legal determination to be left to this Court. Creditors should be apprised (objectively) of the strengths and weaknesses of PG&E's position, particularly given this Court's stated reluctance to solve "PG&E's, or California's or the country's energy crisis." *Pacific Gas & Elec. Co.* v. *California Public Utilities Comm'n, et al. (In re Pacific Gas & Elec. Co.)*, 263 B.R. 306, 309 (Bankr. N.D. Cal. 2001) (noting that "[t]hat is for others to attempt.").

In a similar vein, PG&E should be required to disclose the obstacles, risks and costs involved in obtaining the various regulatory approvals needed to effectuate its Plan. PG&E should expect that the regulatory approvals and certificates it seeks from the FERC, SEC, NRC and others will be challenged by the CPUC and others whose rights it seeks to affect before those regulatory bodies. All of this should be disclosed.

PG&E seeks here and, ultimately, the chapter 11 plan approved in *PSNH* was a consensual one, rather than a litigation result. Moreover, *PSNH* has no precedential value in this Circuit.

C. PG&E Should Disclose the Laws it Seeks to Preempt.

PG&E should not be allowed to claim preemption of various state and local laws and regulations without first specifically identifying them. Preemption inquiries require precise statutory analyses of both the federal and state statutes in question and an examination of the legislative history of each. 1 Lawrence Tribe, *American Constitutional Law* § 6-28 p. 1177 (3d ed. 2000) ("[T]he most fundamental point to remember is that preemption analysis is, or at least should be, a matter of precise statutory construction rather than an exercise in free-form judicial policymaking."); 2 Ronald Rotunda & John E. Nowak, *Treatise on Constitutional Law*, § 12.1 (3d ed. 1999) ("Before a judicial determination occurs, therefore, the Court must consider the federal law and its operation compared with the state statute and its operation.").

PG&E's assertions that it will seek an affirmative ruling of this Court that section 1123 of the Bankruptcy Code preempts various "state and local laws," are insufficient under any preemption analysis.[26] Instead, PG&E should identify each and every state and local law and regulation it seeks to preempt. Because preemption forms the undergirding of PG&E's Plan, such disclosure is necessary so that interested parties will be on notice of the laws PG&E seek to preempt. In addition, if this Court overrules the CPUC's and others' Adversary Proceeding Objections, then the Disclosure Statement may serve as the only notice of the Plan's preemptive sweep.[27]

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[26] *See, e.g.*, D.S. at 74, 76-77, 80-81; *see also* D.S. at 84 (noting that PG&E will seek a ruling that section 1123 preempts "*certain provisions* of the California Corporations Code in connection with the Internal Restructurings and the Reorganized Debtor Spin-Off") (emphasis added).

[27] The CPUC has tried on its own to identify the myriad laws and regulations PG&E seeks to preempt, and the list is long. However, the CPUC and others should not be required to engage in a guessing game. As the party seeking the relief, PG&E should be required to clearly identify each law it hopes to preempt.

D. The Disclosure Statement Fails to Disclose Adequately (a) the Values of the Assets it Seeks to Transfer, (b) the Consideration to be Received in Exchange, and (c) the Identities of the Transferees.[28]

PG&E should disclose the (a) market values of the assets it seeks to transfer to each of ETrans, GTrans and Gen (and their respective subsidiaries and affiliates), (b) the precise consideration to be received by the Reorganized Debtor in exchange therefor, and (c) the identities of the transferees. Presently the Plan and Disclosure Statement provide only as follows:

> (a) PG&E's electric transmission assets will be transferred to ETrans (or one or more subsidiaries or affiliates of ETrans) in partial consideration of $770 million in cash (subject to adjustment), $380 million in long-term notes and the assumption of certain (unspecified) liabilities;
>
> (b) PG&E's gas transmission and storage assets will be transferred to GTrans (or one or more subsidiaries or affiliates of GTrans) in partial consideration of $390 million in cash (subject to adjustment), $420 million in long-term notes and the assumption of certain (unspecified) liabilities; and
>
> (c) PG&E's generation assets will be transferred to Gen (or one or more subsidiaries or affiliates of Gen) in partial consideration of $200 million in cash (subject to adjustment), $1.9 billion in long-term notes and the assumption of certain (unspecified) liabilities.

D.S. at 71, 75, 78.

PG&E's disclosure in this area is woefully inadequate. First, PG&E fails to disclose the market values of the assets to be transferred. A comparison of the market values and the consideration to be paid for such assets is necessary so that PG&E's creditors can make informed decisions about whether such transfers are fair and reasonable or, alternatively, whether they reflect sweetheart deals between PG&E and its Parent. For example, how can PG&E justify the transfer of its generation assets to Gen for only $2.1 billion in cash, notes and the assumption of certain (unspecified) liabilities when PG&E itself recently valued its hydroelectric assets alone at approximately $4.1 billion in proceedings before the CPUC to determine whether the rate freeze has ended? In other words, if PG&E believes that its generation assets are worth in excess of

[28] Schedules identifying the precise assets to be transferred should be annexed to the Disclosure Statement.

$4.1 billion, then why is it willing to transfer them to its Parent for only $2.1 billion? PG&E should be required to explain this and any other discrepancies in the values of the assets to be transferred and the consideration to be received in exchange therefor.

In addition, PG&E should have to disclose the precise consideration to be paid for such assets. It cannot suffice for PG&E to disclose only the "partial consideration" to be received or that the cash portion of the consideration remains "subject to adjustment" or the assumed liabilities unspecified. Rather, PG&E must disclose all of the consideration to be received and specify, at a minimum, the reasons for any adjustments to the cash portion of the consideration. As for the assumed liabilities, PG&E knows what they are and should be forced to disclose them. *See, e.g.*, D.S. at 73, 79 (noting that the FERC must approve ETrans' and Gen's assumption of liabilities; PG&E anticipates making its FERC filings on or before November 30, 2001).

Finally, PG&E should disclose the identities of the entities to whom such assets will be transferred. PG&E recently filed notices with the CPUC of its intent to form a number of Parent subsidiaries and affiliates in anticipation of implementing its Plan. The names of these entities along with descriptions of the assets to be transferred to each should be included in the Disclosure Statement. It is not sufficient for the Disclosure Statement merely to recite that "[t]he Debtor *may* also create indirect subsidiaries or affiliates to hold other assets." *See* D.S. at 5 (emphasis added).

E. <u>Litigation</u>.

Section VI(H) of the Disclosure Statement, captioned "Litigation," describes certain claims PG&E's estate has against third parties,[29] as well as certain claims asserted against PG&E. D.S. at 87-91. Lacking, however, are any objective assessments of such claims, including (i) PG&E's claims in the Rate Recovery Litigation[30], the BFM Contract Seizure

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[29] Excluding, notably, potential claims against the Parent and generators and other power sellers. *See* pp. 17-19, *supra*.

[30] At a minimum, PG&E should disclose that the CPUC has moved to dismiss PG&E's complaint in that case.

Litigation, and the appeal of this Court's Order dismissing PG&E's complaint in its adversary proceeding against the CPUC and its Commissioners, all of which PG&E believes are significant estate assets, and (ii) the claims asserted against PG&E in the Compressor Station Chromium Litigation. Also lacking is any explanation of why PG&E's Plan provides for the assignment of virtually the entire recovery (if any) in each such case, as well as its claims against the State, to Newco or its subsidiary.[31] These assignments are particularly troubling given that it is PG&E or the Reorganized Debtor, not the Parent or Newco, that will continue funding such lawsuits. PG&E needs to explain these transfers and to justify them, if possible.

A further issue is PG&E's description of its adversary proceeding against the CPUC and its Commissioners. *See* D.S. at 52, 62. In its description, PG&E never discloses that its adversary complaint was dismissed *with prejudice*. Nor does it disclose this Court's reluctance to solve California's or PG&E's energy crisis (a disclosure that is particularly relevant in light of the sweeping relief PG&E seeks under its Plan). *See* p. 20, *supra*. Further, on page 62 of the Disclosure Statement, PG&E mistakenly represents that its adversary complaint was filed "in accordance with the automatic stay provision of the Bankruptcy Code . . . ." Clearly, this Court decided otherwise. PG&E should be compelled to clarify and correct each of these items.

F. <u>Corporate Governance</u>.

The Disclosure Statement fails to identify the members of the boards of directors or control (as applicable) or the senior management of each of ETrans, Gtrans, Gen and the Reorganized Debtor. D.S. at 72, 75, 78, 83. These disclosures are required by law and, in any event, are a prerequisite to plan confirmation.[32] Their importance is particularly significant

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[31] *See, e.g.*, D.S. at 88 (noting that PG&E will assign to Newco or its subsidiary "the rights to 95% of the of the net after-tax proceeds from any successful resolution of the Rate Recovery Litigation and resulting CPUC rate order requiring collection in rates."); D.S. at 91 (noting similar assignments of recoveries from the BFM Contract Seizure Litigation and from claims against the CPUC and the State regarding PG&E's transition cost recovery).

[32] *See* 11 U.S.C. § 1129(a)(5), providing that:

> (a) The court shall confirm a plan only if all of the following requirements are met:

where, as here, there is the potential for interlocking directorates and sharing of management roles and responsibilities, which give rise to obvious conflict-of-interest concerns. Therefore, PG&E should be required to include this information in its Disclosure Statement.

G. Executory Contracts and Unexpired Leases.

PG&E's Disclosure Statement should list and briefly describe each significant executory contract and unexpired lease that it anticipates assuming, assuming and assigning to a third party (including such third party's identity), or rejecting. The cure amount for each such contract or lease to be assumed, or assumed and assigned, should similarly be disclosed. Finally, PG&E should update Section V(14) of the Disclosure Statement to reflect this Court's grant or denial, as the case may be, of any further requested extensions of the time within which PG&E may assume or reject its unexpired real property leases. D.S. at 63 (reflects extension only through October 5, 2001).

H. Asset Sales.

PG&E's Disclosure Statement provides that "[c]ertain other assets of the Debtor deemed not essential to operations will be sold under the Plan." D.S. at 65 (providing that PG&E expects to yield approximately $75 million from the sale of certain land parcels and property rights it deems nonessential). PG&E should specifically identify the assets to be sold and their approximate values.

> (5)(A)(i) The proponent of the plan has disclosed the identity and affiliations of any individual proposed to serve, after confirmation of the plan, as a director, officer, or voting trustee of the debtor, an affiliate of the debtor participating in a joint plan with the debtor, or a successor to the debtor under the plan; and (ii) the appointment to, or continuance in, such office of such individual, is consistent with the interests of creditors and equity security holders and with public policy; and
>
> (B) the proponent of the plan has disclosed the identity of any insider that will be employed or retained by the reorganized debtor, and the nature of any compensation for such insider.

11 U.S.C. § 1129(a)(5).

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I. Other items.

(i) Certain allocations among ETrans, GTrans, Gen and the Reorganized Debtor

No basis exists, nor is one offered, for the following allocations among ETrans, GTrans, Gen and the Reorganized Debtor:

- The long-term notes to be issued under the Plan by each of ETrans (12%), GTrans (15%) and Gen (73%). D.S. at 14 n.1.

- The long-term subordinated notes to be issued to holders of QUIDS Claims (Class 11) by each of ETrans (27.5%), GTrans (19.8%) and Gen (52.7%). D.S. at 22.

- The Reorganized Debtor remaining solely liable on the Mortgage Backed PC Bond Claims (Class 4a), the MBIA Insured PC Bond Claims (Class 4b), the MBIA Claims (Class 4c), the Prior Bond Claims (Class 4f), and the Treasury PC Bond Claims (Class 4g). D.S. at 15-19. This is especially puzzling given that many of the assets securing such claims are to be transferred to ETrans, GTrans and Gen.

- Liability for the Letter of Credit Backed PC Bond Claims (Class 4d) and the Letter of Credit Bank Claims (Class 4e) being shared among the Reorganized Debtor (26%), ETrans (17%), GTrans (14%) and Gen (43%), respectively. D.S. at 16-18.

- Liability for the Allowed Chromium Litigation Claims for Actual Damages (Class 9a) and Punitive Damages (Class 9b) being shared among the Reorganized Debtor (50%), ETrans (12.5%), GTrans (12.5%) and Gen 25%. D.S. at 20-21.

PG&E should be required to explain and to justify each such allocation, if possible.

(ii) Estimate of PX, ISO and Generator Claims (Class 6)

PG&E fails to substantiate its $1.060 billion estimate of the PX, ISO and Generator Claims (Class 6)[33] despite its admission that the filed claim amounts are substantially higher. PG&E should explain the variance between the filed and estimated claim amounts and disclose whether its Plan can be consummated if the actual claim amounts exceed PG&E's estimate.

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[33] PG&E represents that this amount also includes an estimate of the allowable ESP Claims. D.S. at 19 n. 4. This is perplexing given that the ESP Claims are separately classified in Class 7 and are estimated to equal $4.204 billion. *Id.*

(iii) The Plan Supplement

PG&E's Plan Supplement should be on file with the Court and made available to interested parties at or prior to the time that its Disclosure Statement is disseminated.[34] According to the Disclosure Statement, the Plan Supplement will contain, among others things, material agreements to be entered into between the Reorganized Debtor and each of ETrans, GTrans and Gen.[35] Inasmuch as these agreements will largely govern the relations among these entities subsequent to PG&E's reorganization, their terms should be disclosed up front so they may inform decisions to accept or reject the Plan.

(iv) Employee Issues

PG&E should be required to identify the individuals to be employed by each of the Reorganized Debtor, ETrans, GTrans and Gen. In addition, PG&E should disclose each entity's additional employee-related costs resulting from, among other things, (i) the renegotiation of various collective bargaining agreements with PG&E's employees, D.S. at 95, (ii) the need for new hires as a result of the Internal Restructurings (*e.g.*, whereas one person could operate and maintain certain transmission and distribution assets, two may become necessary if ownership of those assets no longer is shared), and (iii) the increased cost of the Reorganized Debtor's workers' compensation insurance given that the Parent will no longer guarantee payment of such claims.[36] D.S. at 96. Finally, PG&E should quantify the cost to ETrans, GTrans and Gen and

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[34] Presently, the Disclosure Statement provides only that the Plan Supplement will be filed at least ten days prior to the voting deadline. D.S. at 129.

[35] These include, without limitation, the Power Sales Agreement to be entered into between the Reorganized Debtor and Gen, the gas transmission and storage agreement to be entered into between the Reorganized Debtor and GTrans, and the master separation and distribution agreement to be entered into among the Reorganized Debtor, ETrans, GTrans and Gen. D.S. at 85-86, 92-93.

[36] On a related issue, PG&E should explain the statement on page 120 of the Disclosure Statement that all workers' compensation programs are to be treated as executory contracts and assumed under the Plan. PG&E's Plan provides for drastic changes to its workers' compensation program as a result of the Internal Restructurings. It is unclear just how PG&E can assume such programs *cum onore*, as it is required to under section 365 of the Bankruptcy Code, in light of such expected changes.

the impact upon its reorganization if this Court holds that the CPUC's affiliate transaction rules apply.[37]

(v) Claims Resolution

PG&E should disclose where it is in the claims allowance process and, assuming it obtains all of the preemptive and other relief it seeks in connection with its Plan, when creditors might expect distributions on their allowed claims.

(vi) $40 million "Placement Fee"

PG&E's Plan provides that, in addition to being paid in full with interest, holders of allowed claims in Classes 5 (Unsecured Claims), 6 (ISO, PX and Generator Claims), 7 (ESP Claims) and 9 (Chromium Litigation Claims for Actual Damages) will each receive its *pro rata* share of a $40 million "placement fee." D.S. at 19-21. It is unclear from the Plan what that placement fee represents and whether it is part of the consideration to be paid to holders of allowed claims in those classes on account of such claims. If the placement fee constitutes an additional distribution on such allowed claims, then PG&E's Plan may be unconfirmable in that it unfairly discriminates in favor of creditors in those classes and provides them with greater than a full recovery on their allowed claims. Alternatively, if the placement fee is something else, PG&E should state what it is and under what circumstances and why it is to be paid.

(vii) DWR's Revenue Requirement

The Disclosure Statement's discussion of DWR's revenue requirement and the CPUC's proceedings and PG&E's and others' challenges relating thereto is inaccurate, stale and in need of updating. PG&E's description has been superseded in many key respects by intervening events since the filing of its Disclosure Statement.

[37] The CPUC's affiliate transaction rules require that a utility be compensated whenever a utility-employee is transferred to an affiliate. In the past, the CPUC has determined that a utility should be paid 25% of the worker's annual compensation.

(viii) Gen as a "Public Utility"

At page 151 of its Disclosure Statement, PG&E states that it will seek an affirmative ruling of this Court that Gen's facilities will not be dedicated to the public and, thus, that Gen is not a "public utility" within the meaning of the California Public Utilities Code. Elsewhere in its Disclosure Statement, however, PG&E freely admits that Gen is indeed a "public utility." D.S. at 73, 80 (noting that the Parent will own two public utilities – ETrans and Gen). Which is it?

(ix) Hunters Point and Humboldt Bay Power Plants

PG&E fails to explain why the Hunters Point and Humboldt Bay Power Plants will remain with the Reorganized Debtor and not be transferred along with PG&E's other generation assets to Gen. Is the Parent seeking to saddle the Reorganized Debtor with the decommissioning responsibilities associated with these power plants?

(x) Mortgage Backed PC Bond Claims, MBIA Insured PC Bond Claims and Treasury PC Bond Claims

As noted above, the Plan provides that the Reorganized Debtor will remain solely liable for payment of PG&E's Mortgage Backed PC Bond Claims, MBIA Insured PC Bond Claims and Treasury PC Bond Claims (Classes 4a, 4b and 4g, respectively). Yet, certain of the obligations under the loan documents covering such claims contain covenants that require ETrans', GTrans' and Gen's compliance (as applicable). *See e.g.*, D.S. at 102-103, 110-111.[38] If ETrans, GTrans

[38] Those portions of the Disclosure Statement provide as follows:

> With respect to any property transferred by the Debtor to ETrans, GTrans or Gen pursuant to the terms of the Plan, the acquisition or construction of which was financed or refinaned with the proceeds of a series of Mortgage Backed PC Bonds [, MBIA Insured PC Bonds or Treasury PC Bonds, as the case may be], the transferee shall assume the obligation to perform, satisfy and/or comply with those terms, covenants, conditions or obligations under the related PC Bond Documents arising from and after the Effective Date which are to be observed, performed, satisfied or complied with by the owner or operator of the "Project" (as described therein) or any portion thereof which is then owned or controlled by such party, including, without limitation, (a) any obligation to maintain such Project or portion thereof and its other assets and to timely pay any taxes, governmental charges, assessments, insurance premiums or other costs or expenses related thereto, (b) the obligation to comply

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and/or Gen fail to comply with these covenants, then any resulting liability will be borne solely by the Reorganized Debtor, despite the fact that the Reorganized Debtor cannot compel their compliance. This risk should be disclosed.

(xi) Resumption of the Net Short

PG&E's self-imposed criteria for the Reorganized Debtor's resumption of the net short are at best unclear and confusing. *See, e.g.*, D.S. at 66 (setting forth the criteria). For example, PG&E fails to disclose the party responsible for establishing the objective retail rate recovery mechanism or the objective procurement standards. Will it be this Court, the CPUC, the Reorganized Debtor or some other body or entity? Equally unclear, is what PG&E means when it says that the Reorganized Debtor will assume the net open position "not already provided through the DWR's contracts . . . ." *Id.* Currently, DWR covers the entire net short, much of it through contracts it has with power suppliers. Under PG&E's formulation, what does PG&E forecast would remain for the Reorganized Debtor to cover? The Disclosure Statement needs to provide answers to these questions.

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with all restrictions on the use of such Project or portion thereof set forth in the related PC Bond Documents, and (c) the obligation to refrain from taking any action or permitting any action to be taken with respect to such Project or portion thereof that could cause interest on the related series of PC Bonds to become includable in the gross income of the holders thereof for federal income tax purposes.

(xii) Separate Classification of the Environmental and Tort Claims for Actual and Punitive Damages (Classes 8a and 8b, respectively) and the Chromium Litigation Claims for Actual and Punitive Damages (Classes 9a and 9b, respectively)

PG&E offers no justification for the separate classification and treatment of the Environmental and Tort Claims for Actual and Punitive Damages (Classes 8a and 8b, respectively), on the one hand, and the Chromium Litigation Claims for Actual and Punitive Damages (Classes 9a and 9b, respectively), on the other.

(xiii) Tax Consequences

According to PG&E's Disclosure Statement, the Proponents will seek a private letter ruling from the IRS or, alternatively, a legal opinion from their tax advisors, stating that the Internal Restructurings and the Reorganized Debtors Spin-Off will not be taxable events. D.S. at 163-64. PG&E admits, however, that any resulting tax liability could be substantial. *Id.* at 164. PG&E should estimate the amount of such potential tax liability and describe its potential impact on PG&E's proposed reorganization.

CONCLUSION

For the reasons set forth herein, the CPUC respectfully requests that this Court refuse to approve PG&E's Disclosure Statement.

DATED: November 27, 2001

Respectfully submitted,

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-and-

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UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF CALIFORNIA
SAN FRANCISCO DIVISION

In re	Case No. 01-30923 DM
PACIFIC GAS AND ELECTRIC COMPANY, a California corporation, Debtor. Federal I.D. No. 94-0742640	Chapter 11 Case **OBJECTION TO PACIFIC GAS & ELECTRIC COMPANY'S SECOND MOTION FOR ORDER FURTHER EXTENDING EXCLUSIVITY PERIOD FOR FILING PLAN OF REORGANIZATION TO PERMIT THE CALIFORNIA PUBLIC UTILITIES COMMISSION TO FILE AN ALTERNATE PLAN OF REORGANIZATION** Date: January 16, 2002 Time: 9:30 a.m. Place: 235 Pine Street, 22nd Floor, San Francisco, California Judge: Hon. Dennis Montali

[SUPPORTING DECLARATION OF GARY M. COHEN FILED SEPARATELY]

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The California Public Utilities Commission (the "Commission"), a creditor and party in interest in this chapter 11 case, by and through its undersigned counsel, submits this objection (the "Objection") to Pacific Gas & Electric Company's Second Motion for Order Further Extending Exclusivity Period for Filing Plan of Reorganization (the "Second Extension Motion") to permit the Commission to file its alternative plan of reorganization (the "Alternate Plan"). In support of its Objection, the Commission respectfully represents as follows:

I.

PRELIMINARY STATEMENT

Plan exclusivity extensions must be earned by hard bargaining. That is the clear purpose and intent of section 1121(d) of the Bankruptcy Code, which balances the estate's interest in promoting a consensual reorganization plan with the debtor's urge to use its exclusive right tactically to compel creditors and other interested parties to accede to its view of the world. It is that very tension that is at issue in the Second Extension Motion filed by Pacific Gas & Electric Company ("PG&E").

PG&E has enjoyed the exclusive right to file a plan of reorganization for more than nine months, since April 6, 2001. During that period, PG&E has not even attempted to negotiate with the Commission, its chief regulator. Instead, PG&E has initiated a frontal assault on the Commission's and the State's regulatory authority. From the first days of this case, when PG&E filed an adversary proceeding to strike a portion of a Commission order, to its plan filing some five months later, PG&E's strategy has been obvious – it prefers to fight, rather than reach agreement, with the Commission.

Its confirmation efforts complicated by its own belligerence, PG&E seeks an additional four month extension of its exclusive period, until June 30, 2002, to seek confirmation of its plan. PG&E has not earned such an extension. PG&E has enjoyed nine months of exclusivity and the time has now come to level the playing field. PG&E's creditors and other interested parties no longer should be held hostage to PG&E's battle plans against the Commission. In addition, a further extension of exclusivity would unjustifiably reward PG&E for pursuing

precisely the type of "take-it-or-leave-it" attitude section 1121(d) of the Bankruptcy Code is designed to prevent.

As described more fully in the Declaration of Gary M. Cohen filed in support hereof (the "Cohen Declaration"), the Commission has developed an alternate approach, and this Court should deny PG&E's Second Extension Motion to the extent necessary to permit the Commission to file and solicit acceptances to its Alternate Plan. Such an approach is fully justified. To begin with, PG&E has failed to meet its burden of establishing "cause" for its second exclusivity extension, as it is required to do under section 1121(d) of the Bankruptcy Code. In fact, PG&E's Second Extension Motion does not contain *any* evidence of "cause." Rather, the Motion contains only unsupported allegations of alleged progress toward confirmation of a plan and the size and complexity of this case. PG&E's Sec. Ext. Mot. at 7-9. That, without more, is insufficient to satisfy the "cause" requirement.

The truth is, PG&E has made little, if any, progress toward confirmation of a *consensual* plan. As is obvious from the roughly 70 Disclosure Statement objections filed to date, the Plan does not enjoy the support of key constituencies in this case, including the Commission and the State of California, and PG&E has done nothing to gain their support. Moreover, as those objections point out, the Plan is infirm in a number of respects, leaving its confirmability in doubt. Allowing PG&E to proceed with its current Plan to the exclusion of all others may result in nothing more than wasted time and delay at the expense of PG&E's creditors who, in PG&E's own words, are footing the bill for "literally millions of dollars per week in fees, costs and interest accruals with respect to creditor claims." PG&E's Sec. Ext. Mot. at 4.

Similarly, the size and alleged complexity of this case do not support PG&E's second requested extension. While this case is no doubt large, its size is largely irrelevant to PG&E's need to maintain plan exclusivity. Size is important, where, unlike here, the existence of multiple creditor constituencies with varying rights and priorities magnify the difficulty of negotiating a consensual plan. Here, PG&E purportedly is offering to pay creditors in full.

Regardless of the number of constituencies involved, it should not be difficult for PG&E to convince creditors to take 100 cents-on-the-dollar. In short, size really does not matter.

PG&E's assertions of complexity are similarly unavailing. Much of the complexity surrounding this case has been engineered by PG&E. If PG&E were concerned only with debtor-creditor issues and emerging quickly from bankruptcy, more mundane alternatives exist for it to do so. In fact, the Commission has developed one such alternative, which is described below and in the Cohen Declaration. But, PG&E obviously is more interested in walking a legal minefield in an effort to remove itself from Commission and State regulation. Thus, PG&E itself has unnecessarily complicated matters by foisting upon creditors and this Court its complicated preemption battle. PG&E should not be allowed to create complexity where none needs to exist and then use it as a basis to monopolize the plan process.

"Cause" lacking, PG&E should not be granted a further extension of its exclusive period. Rather, this Court should deny PG&E's requested extension to allow the Commission to file and solicit acceptances to its own Alternate Plan. The Commission is keenly interested in PG&E's reorganization and has worked diligently to construct its Alternate Plan. The Commission is now poised, with this Court's permission, to present creditors and this Court with an alternative that, among other things, pays creditors in full in cash in a manner that is consistent with the broader interests of the State of California and PG&E's ratepayers, allows PG&E to emerge promptly from chapter 11 as a viable, creditworthy utility and avoids the costly preemption litigation at the heart of PG&E's Plan. Whereas creditors currently are stranded by PG&E's "take-it-or-leave-it" approach, they would now have a choice.

Accordingly, as discussed more fully below, the Commission requests that PG&E's Second Extension Motion be denied to permit the Commission to file its Alternate Plan.

II.

BACKGROUND

1. On April 6, 2001 (the "Petition Date"), PG&E filed a voluntary petition under chapter 11 of title 11 of the United States Code, 11 U.S.C. §§ 101 *et seq.* (the "Bankruptcy

Code"). PG&E continues to manage and operate its business and property as a debtor in possession pursuant to sections 1107 and 1108 of the Bankruptcy Code. No trustee has been appointed in this case.

2. The Commission is an independent, Constitutional agency of the State of California charged with, among other things, regulating California's public utilities. Cohen Decl. ¶ 2. PG&E is a public utility subject to the Commission's jurisdiction. *Id.* The Commission is also a creditor of PG&E and a party in interest in this case with standing to file a plan of reorganization.[1]

3. On July 3, 2001, PG&E made its first request to extend exclusivity, which was granted by an order (the "Extension Order") of the Court dated July 20, 2001. Order Extending Exclusivity Period, *In re Pacific Gas & Elec. Co.*, No. 01-30923 DM (Bankr. N.D. Cal., July 20, 2001). PG&E's first request was premised principally upon the size and alleged complexity of its chapter 11 case and its need for additional time to develop a plan of reorganization. Debtor's Motion for Order Extending Exclusivity Period For Filing Plan of Reorganization at 7-8. The Extension Order granted PG&E an additional four months within which to file a plan, until December 6, 2001, and in the event that PG&E did file a plan by December 6, 2001, the Extension Order extended the period during which plan exclusivity was maintained under section 1121(c)(3) until February 4, 2002. Extension Order at 1.

4. On September 20, 2001, PG&E, together with its parent company, PG&E Corporation (the "Parent"), as co-proponent, filed a Plan of Reorganization under Chapter 11 of the Bankruptcy Code for Pacific Gas and Electric Company (as amended, the "Plan") together with a proposed disclosure statement (as amended, the "Disclosure Statement").

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[1] On October 2, 2001, the Commission filed a proof of claim for approximately $12 million representing amounts due from PG&E for, among other things, unpaid fees and expenses under the California Environmental Quality Act and unpaid user fees and other amounts due under the Women/Minority/Disabled/Veteran Business Enterprise Program.

5. The Plan and Disclosure Statement were prepared and filed without any negotiation or substantive discussion with many of the key players involved in this case and in the regulation of PG&E's operations, including the Commission. Cohen Decl. ¶ 8.

6. As this Court is keenly aware, the Plan is premised, in large part, upon PG&E's wholesale transfer of its generation and its electric and gas transmission assets to newly formed entities that would be beyond the purview of Commission regulation. First Am. Plan, Art. 7. In addition, the Plan hinges on PG&E's receipt of no fewer than fifteen affirmative declaratory and injunctive rulings against the Commission and various other State and local agencies, and approvals from the Federal Energy Regulatory Commission ("FERC"), the Securities and Exchange Commission ("SEC") and the Nuclear Regulatory Commission ("NRC"), all of which will be the subject of significant litigation before this Court and elsewhere. First Am. Plan, Art. 7, 8; First Am. D.S. at 123, 200-01. Assuming PG&E is successful on all of these fronts, the Plan allegedly provides for creditor claims to be satisfied in full, with interest, in the form of either cash or a combination of cash and debt securities. First Am. Plan, Art. 4.

7. As set forth more fully in the Commission's Objection to PG&E's Disclosure Statement, filed on November 27, 2001 (the "Disclosure Statement Objection"), the Commission submits that PG&E's Plan, which attempts to preempt myriad Commission, State and local laws and regulations, is unlawful and incapable of being confirmed.

8. Specifically, the Commission and other parties have identified the following critical confirmation infirmities:

- The Plan may not comply with the Bankruptcy Code, as required by section 1129(a)(1), because it fails to contain adequate means for its implementation, a requirement under section 1123(a)(5) of the Bankruptcy Code. Discl. Stmt. Obj. 6-9.
- The Plan has not been proposed in good faith, as required by section 1129(a)(3), because it is inconsistent with the purposes and objectives of the Bankruptcy Code. *Id.* at 9-13.
- The Plan may provide for hidden rate increases without Commission approval, in violation of section 1129(a)(6) of the Bankruptcy Code. *Id.* at 14.
- The Plan may not be feasible, as required by section 1129(a)(11). The Plan is predicated entirely upon PG&E's receipt of favorable rulings on many of its

requests for declaratory and injunctive relief relating to preemption, as well as favorable outcomes at the FERC, SEC and NRC. Until PG&E obtains such rulings, a feasibility determination is impossible. *Id.* at 14-15.

- The Plan fails the "best interests" test of section 1129(a)(7) of the Bankruptcy Code because it seeks to transfer proceeds of the Rate Recovery Litigation (as defined in the Plan) and other litigation to the Parent. *See* Objection of Certain Debtholders to Approval of the Disclosure Statement for Plan of Reorganization of Pacific Gas and Electric Company and PG&E Corp. at 10-14.
- The Plan improperly grants third party releases to the Parent and other creditors. *Id.* at 14-15.
- The Plan fails to comply with the "absolute priority rule" under section 1129(b)(2) of the Bankruptcy Code because it (a) allows equity holders to retain their ownership interest in PG&E when senior creditors are not paid in full, and (b) provides that QUIDS claimants will receive property of PG&E when senior creditors have not been paid in full. *Id.* at 15-19.

9. Pursuant to this Court's Order dated December 5, 2001, PG&E filed its amended Plan and Disclosure Statement on December 19, 2001. Hearings to consider approval of the amended Disclosure Statement are scheduled for January 14, 2002, to address the adequacy of disclosure only, and January 25, 2002, to address whether PG&E's Plan is unconfirmable as a matter of law based upon sovereign immunity or preemption grounds.

10. Pursuant to this Court's December 5th Order, on December 18, 2001, the Commission and its counsel met with PG&E and its counsel and counsel to the Parent to discuss the Commission's objections to the Disclosure Statement. Cohen Decl. ¶ 8. As of the date of this Objection, many of the Commission's objections to the Disclosure Statement remain unaddressed by the amended Disclosure Statement, although the Commission and PG&E have scheduled a further "meet and confer" for January 9, 2001. *Id.* at ¶ 6.

11. On December 19, 2001, PG&E filed its Second Extension Motion.

III.

COMMISSION'S ALTERNATE PLAN[2]

Faced with PG&E's refusal to negotiate, the Commission has developed its Alternate Plan. Now, with PG&E's exclusive right about to expire (absent an extension), the Commission

[2] The following description of the Alternate Plan is for informational purposes and is included only as support for this Objection. By this Objection, the Commission is not proposing an alternative plan nor is it soliciting acceptances to any such alternative or rejections of PG&E's Plan.

is prepared to describe the salient features of its Alternate Plan and, with this Court's permission, to file a plan and disclosure statement in short order.

The following are certain of the significant provisions of the Commission's Alternate Plan:

- PG&E's short-term borrowings incurred during the energy crisis would be paid in full in cash (including accrued and unpaid interest through the effective date) by the first quarter of 2003 through a combination of PG&E's cash on hand (approximately $4.9 billion as of November 30, 2001 according to PG&E's most recent 8-K filing with the SEC)[3] and PG&E's residual revenues after deducting authorized revenue requirements from billed revenues ("residual revenues");
- all of PG&E's remaining indebtedness would be reinstated or refinanced;
- PG&E's creditworthiness and financial viability would be restored – the Commission would adopt a post-bankruptcy rate structure consistent with state law that would provide PG&E with an opportunity to earn a reasonable return that would allow it to maintain an investment-grade credit rating;
- valuable claims against the Parent (which under PG&E's Plan are to be released)[4] and other assets such as PG&E's refund claims pending before FERC would be preserved and transferred to a litigation trust or similar entity and prosecuted for the benefit of PG&E's ratepayers;
- costly and time-consuming preemption litigation would be avoided;
- PG&E would emerge promptly from chapter 11;
- the Commission and State of California would continue to regulate PG&E's operations;
- PG&E's integrated operations would not be disaggregated;
- rates would not increase, and may be reduced in 2003 (or earlier);
- utility assets would not be diverted to pay the Parent's expenses; and
- costly litigation at the FERC, NRC and SEC would be avoided.

Cohen Decl. ¶ 9.

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[3] The Commission expects this number to increase over time. Cohen Decl. ¶ 10.

[4] These claims include, among others, claims that the Parent has violated the "first priority" condition imposed upon the Parent by a Commission order approving PG&E's holding company structure and claims that PG&E declared and paid dividends to its Parent while it was insolvent.

Mindful of the chaos that could ensue if PG&E's plan exclusivity were terminated generally to allow any party in interest to file a plan, the Commission's Objection is more limited. The Commission objects to PG&E's Second Extension solely to allow it to file and solicit acceptances to the Commission's Alternate Plan. For the reasons that follow, the Commission submits that such relief is required under section 1121(d) of the Bankruptcy Code and is in the best interests of PG&E's estate, its creditors and other parties in interests.

IV.

ARGUMENT

PG&E'S SECOND EXTENSION MOTION SHOULD BE DENIED FOR FAILURE TO SHOW "CAUSE" UNDER SECTION 1121(d) OF THE BANKRUPTCY CODE

The Court should deny PG&E's Second Extension Motion to the extent necessary to permit the Commission to file its Alternate Plan because PG&E has failed to meet its burden of establishing "cause" for an extension as required under section 1121(d) of the Bankruptcy Code. 11 U.S.C. § 1121(d)[5]; *In re Dow Corning Corp.*, 208 B.R. 661, 663 (Bankr. E.D. Mich. 1997) ("a debtor bears the burden of proof when it requests an extension of its period of exclusivity"); *In re Express One Int'l, Inc.*, 194 B.R. 98, 100 (Bankr. E.D. Tex. 1996) ("The debtor-in-possession bears the burden of establishing 'cause' for an extension of its exclusivity period."). Though the Bankruptcy Code does not define "cause," it is well established that "cause" is a flexible concept that provides courts with broad discretion in determining when it exists based upon the particular facts and circumstances of each case. *See In re Sharon Steel Corp.*, 78 B.R. 762, 763-64 (Bankr. W.D. Pa. 1987) ("In essence, Congress has left the meaning of the phrase 'for cause' to be determined by the facts and circumstances in each individual case."); *In re Public Serv. Co. of New Hampshire* ("*PSNH*"), 99 B.R. 155, 173 n.10 (Bankr. D.N.H. 1989) ("[I]f a debtor-in-possession is to retain exclusive control of the formulation of a plan of

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[5] Section 1121(d) provides that "[o]n request of a party in interest made within the respective periods specified in subsections (b) and (c) of this section and after notice and a hearing, the court may *for cause* reduce or increase the 120-day period or the 180-day period referred to in this section." 11 U.S.C. § 1121(d) (emphasis added).

reorganization under an exclusivity period it must demonstrate that it uses its position to effectively foster consensual agreement by all entities involved").

Critical to the determination of whether "cause" exists is consideration of the balance Congress intended to strike in section 1121 between the relative negotiating positions of the debtor and its creditors and other key constituents. Section 1121 is the product of Congress' attempt to remedy the imbalance between debtors and creditors found under chapter XI of the former Bankruptcy Act. Under chapter XI, debtors maintained the exclusive right to propose a plan indefinitely, thereby giving debtors undue leverage over creditors whose only recourse was to move for conversion of the case to chapter X, an unattractive alternative. In contrast, under section 1121 of the Bankruptcy Code, debtors enjoy exclusivity only for a limited period of time -- 120 days to file a plan and no more than 180 days from the inception of the case to seek its acceptance -- which may only be extended or reduced upon a showing of "cause." As the legislative history of section 1121(d) makes clear, extensions should not be used to upset the delicate balance Congress sought: "Since the debtor has an exclusive privilege for 6 months during which others may not file a plan, *the granted extension should be based on a showing of some promise of probable success. An extension should not be employed as a tactical device to put pressure on parties in interest to yield to a plan they consider unsatisfactory.*" S. Rep. No. 95-989, at 118 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5787, 5904. *See also In re Pine Run Trust, Inc.*, 67 B.R. 432, 434 (Bankr. E.D. Pa. 1986) ("By granting the debtor a limited period of exclusivity in plan filing, the Code seeks to balance the relative negotiating positions of the debtor and creditors."); *In re Washington –St. Tammany Elec. Coop., Inc.*, 97 B.R. 852, 855 (E.D. La. 1989) ("Congress enacted . . . 1121 in order to limit the debtor's exclusive rights to file a plan to clearly defined periods."); *United Savings Assoc. of Tx.* v. *Timbers of Inwood Forest Assocs., Ltd. (In re Timbers of Inwood Forest Assocs., Ltd.)*, 808 F.2d 363, 372 (5th Cir. 1987) ("[T]he bankruptcy court must avoid reinstituting the imbalance between the debtor and its creditors that characterized proceedings under the old Chapter XI.") (*en banc*), *aff'd*, 484 U.S. 365 (1988).

In balancing the relative positions of various constituencies, courts examine a variety of factors to determine whether "cause" for an extension exists. In one of the leading decisions in this area, the court in *PSNH* considered whether an extension was paid for with "hard bargaining," whether a further extension would promote a consensual plan of reorganization within a reasonable timeframe and whether chaos would ensue following the expiration of exclusivity. *PSNH*, 99 B.R. at 173-77. Other courts have considered multiple factors, many of which amount to variations on the same theme. *See, e.g., Express One Int'l*, 194 B.R. at 100; *Dow Corning*, 208 B.R. at 64-65.[6]

PG&E has not submitted any evidence that "cause" for an extension exists. Instead, its Second Extension Motion is premised solely upon boilerplate suggestions of "cause," including PG&E's alleged progress towards reorganization and the size and complexity of this case. The cited reasons are unsupportable. Even if true, though, they do not add up to "cause." Under such circumstances it is appropriate for the Court to deny PG&E's Second Extension Motion to the extent necessary to allow the Commission to file its Alternate Plan.

A. PG&E Has Not Made Substantial Progress Towards A Successful *Consensual* Reorganization Sufficient To Justify An Extension of Exclusivity.

The purpose of the exclusive period is to enable the debtor to negotiate a *consensual* plan of reorganization with its creditors. *See In re PSNH*, 99 B.R. at 173 n.10 ("if a debtor-in-possession is to retain exclusive control of the formulation of the plan of reorganization under an exclusivity period it must demonstrate that it uses its position to effectively foster consensual

[6] The *Express One* court considered the following factors: (1) size and complexity of the case; (2) necessity of sufficient time to permit the debtor to negotiate a plan of reorganization and prepare adequate information; (3) the existence of good faith progress toward reorganization; (4) the fact that the debtor is paying its bills as they become due; (5) whether the debtor has demonstrated reasonable prospects for filing a viable plan; (6) whether the debtor has made progress in negotiations with its creditors; (7) the amount of time which has elapsed in the case; (8) whether the debtor is seeking an extension of exclusivity to pressure creditors to submit to the debtor's reorganization demands; and (9) whether an unresolved contingency exists. *Express One Int'l*, 194 B.R. at 100. Courts that employ the factors analysis do not merely tally the factors for and against an extension but rather view them holistically. *See Dow Corning*, 208 B.R. at 659 ("Sometimes one or more factors strongly point to a particular result while others point the other way only weakly. And sometimes certain factors are just more relevant or important than others.").

agreement by *all entities involved*") (emphasis added). Accordingly, in evaluating whether cause exists for an extension, courts examine whether there is a "reasonable probability that . . . [the debtor] will be able to propose a plan that will result in a successful reorganization within a reasonable time." *In re Southwest Oil Co. of Jourdanton, Inc.*, 84 B.R. 448, 451 (Bankr. W.D. Tex. 1987); *see In re Pine Run Trust, Inc.*, 67 B.R. 432, 435 (Bankr. E.D. Pa. 1986) (justifying exclusivity extension on, among other things, a finding that "substantial progress has been made in negotiations that, all concede, are critical to a successful reorganization"). Even after a plan is filed, courts evaluate the status of negotiations between the debtor and key parties in interest towards achieving a consensual reorganization. *See generally PSNH*, 99 B.R. at 175-76 (denying debtor utility's second extension request where status of negotiations indicate that a further extension of exclusivity will not promote a consensual plan of reorganization within a reasonable time frame).

PG&E claims that it has made "substantial efforts towards a successful reorganization," citing that (i) it has already filed a Disclosure Statement and Plan which it claims enjoy broad creditor support, (ii) it is in the process of obtaining approval of its Disclosure Statement, and (iii) it has amended the Plan and Disclosure Statement to address concerns raised by interested parties. PG&E's Sec. Ext. Mot. at 9-10. PG&E's submissions in this respect are insufficient to establish cause. First, PG&E has failed to engage in the "hard bargaining" (indeed *any* bargaining) with several key constituencies, which is a necessary prerequisite to a grant of an extension of exclusivity. *PSNH*, 99 B.R. at 173. Second, until critical determinations are made regarding, among other things, the lawfulness of the preemption PG&E seeks under its Plan, its confirmability remains very much in doubt. Therefore, whatever progress PG&E has made to date may prove to be illusory and of no consequence to creditor recoveries and its eventual emergence from chapter 11.

(i) <u>PG&E Has Failed to Negotiate with the Commission and Other Key Parties in Interest.</u>

Extensions of exclusivity must be paid for by "hard bargaining." *Id.* (citing *In re Manville Forest Prods. Corp.*, 31 B.R. 991, 993 (S.D.N.Y. 1983)). As the government body

charged with regulating most of PG&E's operations, the Commission is a critical player in this case. Yet, PG&E has not negotiated any terms of a plan with the Commission, preferring instead to embroil this chapter 11 estate in a risk-laden attack on the Commission's regulatory authority. Such failure to negotiate is fatal to PG&E's Second Extension Motion.

Faced with a similar circumstance of a regulated utility failing to negotiate the terms of its reorganization plan with its regulators, the court in *PSNH* refused to grant the debtor utility a further extension of exclusivity. In that case, the court denied the debtor's second request for an extension of exclusivity because instead of continuing to bargain with state representatives, the debtor filed a non-consensual "FERC plan" similar in some respects to PG&E's Plan. Specifically, in *PSNH* the court found that although representatives of the debtor, the state and key creditor and equity security holder constituencies met on more than one occasion and discussed and exchanged proposals, the debtor was uninterested in making real progress in its negotiations with the state toward a consensual plan of reorganization. *PSNH*, 99 B.R. at 174. Instead, the court found that much like PG&E here, the debtor utility preferred to "stiff arm" th state and go it alone in furtherance of its own agenda. *Id.* at 175. The court there was left only to conclude that after the debtor utility's "FERC plan" was filed, unless exclusivity was terminated and parties were permitted to file alternative plans, there was little likelihood that the debtor and the state would negotiate a consensual plan of reorganization. *Id.* at 176. As a result, the court denied the debtor utility's requested extension of plan exclusivity. *Id.* at 177.

Here, PG&E's behavior is even more egregious than that of *PSNH*. PG&E flat out has not negotiated at all with the Commission. Cohen Decl. ¶ 8. During the approximately nine months in which PG&E has enjoyed exclusivity it has not met with or phoned representatives of the Commission to discuss substantively its Plan. *Id.* The most PG&E has done is to provide one informational "briefing" to Commission staff on November 30, 2001, at which it described its filings with the FERC, SEC and NRC in furtherance of its Plan. There was no negotiation over the terms of the Plan at this briefing. *Id.* In addition, the Commission's counsel attended a court-ordered "meet and confer" session on December 18, 2001 to discuss the Commission's

Disclosure Statement Objection. *Id.* Another "meet and confer" is scheduled for January 9, 2002. *Id.* at ¶ 6.

PG&E's deliberate decision to exclude its chief regulator from the Plan process reflects PG&E's poor judgment and belligerence toward a significant constituency in this case. It also flies directly in the face of section 1121 and its accompanying legislative history, which evince a clear Congressional intent that favors a negotiated, consensual resolution of chapter 11 cases. PG&E's failure to negotiate with the Commission and the State constitutes conduct undeserving of a further extension of exclusivity. Given PG&E's recalcitrance, this Court, like the court in *PSNH*, should promote a consensual plan of reorganization by terminating exclusivity to allow the Commission to file its Alternate Plan. A contrary result would allow PG&E to reap the benefits afforded by plan exclusivity without paying the toll of hard bargaining. It would also allow PG&E to continue to kidnap the plan process to pursue its own deregulation goal, holding the Commission, the State and creditors hostage in the meantime.[7]

(ii) **It is Too Early to Determine Whether PG&E's Plan Can Result in a Successful Reorganization.**

PG&E claims that an extension of exclusivity is warranted because it has "made substantial efforts towards a successful reorganization." PG&E's Sec. Ext. Mot. at 9. PG&E then pins its requested extension on a line of cases as well as section 1121's legislative history which, as PG&E concedes, establish "that exclusivity period extensions are appropriate where the debtor displays some likelihood of a successful, *consensual* reorganization." *Id.* at 8 (emphasis added). PG&E's factual averments are misleading and the cases upon which it relies are factually inapposite.

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[7] PG&E's creditors are hostage to PG&E's "willful blindness" to plan alternatives. PG&E would have those voting on its Plan and this Court believe that its drastic "FERC plan" involving massive dislocations of Commission, state and local laws and regulations is the only plan capable of being confirmed, *i.e.*, that there are no alternatives. First Am. D.S. at 64-65. PG&E is wrong. If allowed to file its Alternate Plan, the Commission intends to show that a very simple alternative exists, one that pays creditors in full in cash by the first quarter of next year without the need for years of litigation. Creditors and other parties in interest should be given the chance to choose the alternative most attractive to them.

First, as detailed above, PG&E has made no effort during this case to build consensus with the Commission on a plan of reorganization. It strains credulity for PG&E to imply otherwise.

Second, despite having filed its Plan more than three months ago, PG&E has been unable to move it out of the starting blocks. As PG&E admits, "70 parties have filed objections to the Disclosure Statement, many of which also reflect opposition to the Plan." PG&E's Sec. Ext. Mot. at 3-4. PG&E further freely concedes that "in view of the sheer number and complexity of the issues involved, it may take months to fully resolve these matters and obtain confirmation of the Plan." *Id.* at 4. PG&E also recognizes that there are likely to be "dozens of contested issues with respect to confirmation of the Plan, many of which are likely to be quite time-consuming to resolve or adjudicate." *Id.* Much of the same can be said of PG&E's various proceedings at the FERC, NRC and SEC. In view of the foregoing, it is premature at best for PG&E to trumpet its efforts at making substantial progress towards a successful reorganization (certainly not a *consensual* reorganization). It may very likely be the case that PG&E's Plan has failed to advance the confirmation ball at all.

Finally, the cases cited by PG&E where courts have granted an extension based in part on a showing of progress towards reorganization are factually inapposite and do not support PG&E's Second Extension Motion. In many, no plan of reorganization had yet been filed, and it still appeared that extra time would afford the parties the opportunity to negotiate a consensual plan.[8] Others involved unique circumstances not present here.[9]

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[8] *See, e.g.*, *In re Pine Run Trust, Inc.*, 67 B.R. 432, 435 (Bankr. E.D. Pa. 1986) (no plan filed; granting first extension to allow debtors who run retirement community to continue negotiations with residents' committee where creditor-objector asked *not* to be included in such negotiations, and there was no evidence that debtor sought additional extension in order to pressure creditors to accede to reorganization demands); *In re Swatara Coal Co.*, 49 B.R. 898, 899-900 (Bankr. E.D. Pa. 1985) (no plan filed; justifying first extension on fact that debtor's owners did not acquire ownership and control of the debtor until nearly three months after case was filed and that pursuant to stipulation and order agreed to by debtor and objector-committee, debtor is required to negotiate with certain parties for a set period yet to expire); *In re McLean Indus., Inc.*, 87 B.R. 830, 833, 835 (Bankr. S.D.N.Y. 1987) (no plan filed; objector *agrees* with course of direction debtor is taking and complex issues relating to liquidation and estimation of certain claims and asset valuation need to be resolved or close to resolution before debtor can negotiate terms of plan, meaningful disclosure can be made to

In short, PG&E's mere filing of a Plan and Disclosure Statement that lacks the support of key constituencies and is legally infirm does not, without more, constitute the type of progress toward a successful reorganization that justifies a further extension of PG&E's exclusive period.

(iii) PG&E's Use of Exclusivity As a Tactical Device to Bully the Commission, the State and its Creditors to Accept its Plan Undermines its Requested Extension.

PG&E further argues that its "progress" towards reorganization justifies "cause" for an extension because "there is nothing to suggest that PG&E seeks the requested extensions in order to pressure its creditors to accede to its reorganization demands." PG&E's Sec. Ext. Mot. at 9. The Commission disagrees. As demonstrated below, PG&E's strategy for seeking a further extension of its exclusive period has at least two objectives: first, it allows PG&E to continue to prevent the Commission from having a meaningful, affirmative voice in its reorganization; and second, by silencing other voices, PG&E can pressure creditors into believing its own rhetoric that "[t]he Plan . . . is, in the Proponents' reasoned opinion, the *only* reasonable solution . . . ." First Am. D.S. at 64-65 (emphasis added). However, where, as here, a debtor seeks to employ exclusivity as a tactical device to force parties in interest to accede to its reorganization demands,

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creditors and creditors will be able to determine their distributions); *In re Gibson & Cushman Dredging Corp.*, 101 B.R. 405, 409-10 (E.D.N.Y. 1989) (no plan filed; debtor's attempts to negotiate with creditors' committee ongoing); *In re Trainer's, Inc.*, 17 B.R. 246, 247 (Bankr. E.D. Pa. 1982) (no plan filed; debtor making substantial efforts to sell main asset, a restaurant).

[9] *In re Homestead Partners, Ltd.*, 197 B.R. 706, 719-20 (Bankr. N.D. Ga. 1996) ("new value" plan filed; court denies motion to terminate by undersecured lienholder on debtor's principal asset because need for competition can be satisfied by requirement that a competitive auction for new equity interest be held at confirmation and grants motion to extend because of lienholder's high degree of recalcitrance and presence of complex legal issues); *In re United Press Int'l, Inc.*, 60 B.R. 265, 271 n.12 (Bankr. D.C. 1986) (granting debtor's motion to extend exclusivity to allow debtor to *file* a plan where the court had previously modified exclusivity to allow creditors' committee and another creditor to file plans); *Gaines* v. *Perkins (In re Perkins)*, 71 B.R. 294, 295, 298 (W.D. Tenn. 1987) (affirming bankruptcy court's decision allowing extension to continue soliciting acceptances where lower court had found, among other things, that the debtor's plan had already received acceptances from all but a few creditors, the two bankruptcy judges in the district had to contend with approximately 14,000 pending cases between them and progress had been made with respect to creditors who had objected to plan); *In re Nicolet, Inc.*, 80 B.R. 733, 744 (Bankr. E.D. Pa. 1988) (decision on exclusivity scheduled for a later date).

courts uniformly hold that such a factor weighs heavily against a finding of "cause" to extend a debtor's plan exclusivity. *See, e.g., PSNH*, 88 B.R. 521, 537 (Bankr. D. N.H. 1988) (courts consider general balancing analysis "to avoid allowing the debtor to hold the creditors and other parties in interest 'hostage' so that the debtor can force its view of an appropriate plan upon the other parties"); *Teachers Ins. & Annuity Assoc. of Am.* v. *Lake in the Woods* (*In re Lake in the Woods*), 10 B.R. 338, 345-46 (E.D. Mich. 1981) (holding that "extensions are impermissible if they are for the purpose of allowing the debtor to prolong reorganization while pressuring a creditor to accede to its point of view on an issue in dispute").

Thus far, PG&E's actions amount to the very "take-it-or-leave-it" attitude Congress sought to prevent by replacing the Bankruptcy Act. *See In re Lake in the Woods*, 10 B.R. at 344 ("'The take-it-or-leave-it attitude on the part of debtors as permitted by Chapter XI is fraught with potential abuse. The granting of authority to creditors to propose plans of reorganization and rehabilitation serves to eliminate the potential harm and disadvantages to creditors [and] democratizes the reorganization process.'") (quoting Bankruptcy Act Revision, Serial No. 27, Part 3, Hearings on H.R. 31 and H.R. 32 before the Subcomm. on Civil and Constitutional Rights of the Comm. on the Judiciary, 94th Cong., 2d Sess. (March 29, 1976) (prepared statement of Harvey R. Miller, William J. Rochelle and J. Ronald Trost) 1875-76 (footnotes omitted)). PG&E's own words evidence that it has foreclosed consideration of all alternatives. *See* First Am. D.S. at 64-65. In so doing, it is forcing creditors to accept its own view of the world and, in the process, using exclusivity to freeze out the Commission and the State while it embarks upon a massive regulatory sea change. Terminating exclusivity now to allow the Commission to file its own Plan would free creditors from the vise PG&E currently has them in and allow the Commission to continue with its State-mandated mission to regulate California's public utilities.

B. <u>The Size and Complexity of PG&E's Chapter 11 Case Do Not Justify an Extension.</u>

Aside from its alleged "progress" toward a successful reorganization, PG&E's only other proffered justification for its requested extension is the often-cited (and overused) "size-and-complexity" excuse. Specifically, PG&E argues that because this case involves "tens of billion.

of dollars of assets, and claims of more than 13,000 creditors" its sheer size together with its exceeding complexity justify its requested extension. PG&E's Sec. Ext. Mot. 7-8. PG&E's argument in this regard elevates form over substance and ignores the fact that PG&E itself has engineered much of the cited complexity.

This is a very large case — of course it is. However, size and complexity do not necessarily go hand in hand. Here, for instance, where creditors likely will be paid in full, much of the complexity associated with having to negotiate with multiple creditor constituencies with different rights and priorities is nonexistent. After all, it should not be difficult to convince creditors to take 100 cents-on-the-dollar with interest. So while the sheer size of this case may present administrative difficulties, it does not support an extension of time ostensibly needed for the debtor to negotiate with its creditors.

Nor can PG&E hide behind the alleged "complexities" of this case in seeking to extend plan exclusivity. PG&E contends that this case "is exceedingly complex, based on, *inter alia*, PG&E's status as a utility company subject to a myriad of state and federal statutes, rules and regulations," many of which PG&E seeks to preempt through confirmation of its Plan. PG&E's Sec. Ext. Mot. at 2, 8.[10] Elsewhere in its Motion PG&E contends that "in view of the sheer number and complexity of the issues [raised in the objections to PG&E's Plan and Disclosure Statement] . . . it may take months to fully resolve these matters and obtain confirmation of the Plan." *Id.* at 4. Nowhere, however, does PG&E mention that it is responsible for much of the complained-of complexity. As evidenced by the Commission's Alternate Plan, alternatives exist to repay creditors in full and to have PG&E emerge from chapter 11. Indeed, the elegance of the Commission's Alternate Plan lies in its simplicity. But PG&E is not interested in simplicity, or primarily in creditor recoveries. Its interests lie elsewhere — in the massive dislocation of the

[10] PG&E further premises the complexity of this case on "the fact that PG&E continues to grapple with an unprecedented energy crisis." PG&E's Sec. Ext. Mo. at 8. PG&E's statement is an exaggeration. As the CPUC's Alternate Plan would very clearly show, PG&E's retail electric rates exceed its wholesale costs, and have since at least around June 2001, leaving PG&E with substantial "residual revenues." Cohen Decl. ¶ 10.

Commission and the State of California's laws and regulations governing its operations. The preemption fight PG&E has started is the cause of much of the complexity surrounding this case, and PG&E should not be permitted to exploit problems it creates.

Finally, size and complexity cannot, without more, constitute "cause" for an extension of exclusivity where other bases for cause are lacking. *See, e.g., In re Sharon Steel Corp.*, 78 B.R. 762, 766 (Bankr. W.D. Pa. 1987) (denying extension of exclusivity despite size and complexity of debtor); *PSNH*, 88 B.R. at 537 (size and complexity alone do not justify extension for cause); *In re Express One Int'l*, 194 B.R. at 100-01 (same). The *PSNH* court thoroughly addressed the circumstances under which size and complexity would justify an extension for "cause" in its decision on the debtor's first extension request:

> It seems clear from a review of the relevant authorities that size and complexity alone cannot suffice as "cause" for a continuation of a debtor's plan exclusivity right in a chapter 11 reorganization. If that were so, a debtor in a case such as the present would automatically have a right to plan exclusivity throughout the proceedings – contrary to the "balancing" and "tension" rationale underlying § 1121 as detailed above. It does stand to reason that a debtor in a large and complex case may make a showing of cause on those facts for exclusivity extension in the *initial stages* of the reorganization by virtue of that factor . . . . If size and complexity *alone* were sufficient cause, that interpretation of the statutory standard would in effect eat up the rule.
>
> The court concludes that an appropriate interpretation of the "for cause" language of § 1121(d) would provide that the size and complexity must be accompanied by other factors pertinent to the particular debtor and its reorganization to justify extension of plan exclusivity, except perhaps in the very early, initial stages of the chapter 11 proceeding. Such factors include those developed in the cases, *i.e.*, <u>the likelihood of an imminent consensual plan if the debtor retains control, no alternate substantial plan being held off by debtor exclusivity, and the general balancing analysis to avoid allowing the debtor to hold the creditors and other parties in interest "hostage" so that the debtor can force its view of an appropriate plan upon the other parties</u>.[11]

[11] In this first *PSNH* decision on exclusivity, an extension was granted principally because the court saw a seven-month "window of opportunity" within which the parties could negotiate towards a consensual plan. 88 B.R. at 538.

PSNH, 88 B.R. at 537 (citations omitted) (underlined emphasis supplied).

Applying this rationale here, size and complexity alone simply do not justify a further extension for PG&E. First, PG&E has already enjoyed one extension, premised at least in part on the size and complexity of its case; granting PG&E another would lead to the very rule-swallowing cautioned against by the court in *PSNH*. Second, confirmation of PG&E's Plan is neither imminent, nor likely to be consensual. Third, here, exclusivity *would* prevent the filing of an "alternate substantial plan," the Commission's Alternate Plan. Finally, as argued above, it appears that the only benefit an extension would offer PG&E would be an opportunity to further cram its views of an appropriate Plan down the throats of creditors, the Commission and other parties in interest that are currently held hostage by PG&E's exclusivity. Under these circumstances, an extension should not rest on "size and complexity."[12]

C. Denying PG&E's Motion to Allow the Commission to File its Alternate Plan Would Benefit Interested Parties Without Prejudicing PG&E.

Terminating PG&E's Plan exclusivity to allow the Commission to file and solicit acceptances to its Alternate Plan is in the best interests of PG&E's creditors and its estate and would not prejudice PG&E. Presently, creditors have only one choice — PG&E's Plan. Their options are to either accept PG&E's Plan and endure years of litigation and uncertainty while they continue to finance, in PG&E's words "literally millions of dollars per week in fees, costs and interest accruals" (PG&E's Sec. Ext. Mot. 4), or to reject PG&E's Plan in the face of no known alternatives. Neither option may be particularly appealing. Fortunately, a third option exists — the Commission's Alternate Plan. As detailed elsewhere, it provides for creditors to be

[12] The cases relied upon by PG&E do not suggest otherwise; in each there existed some independent basis for cause other than size and complexity. *See, e.g., In re Dow Corning*, 80 B.R. at 668 (debtor willing to discuss other means of reorganizing); *In re Express One*, 194 B.R. 100-01 (size and complexity only appropriate consideration where, among other things, no alternative plan); *PSNH*, 88 B.R. at 538 (extension premised principally on "window of opportunity" to negotiate, not size and complexity of debtor); *In re Texaco*, 76 B.R. 322 (plan product of settlement between primary adversaries; plan proposed by party seeking termination is substantially similar, the only changes affecting corporate governance); *In re Perkins*, 71 B.R. at 295 (plan had "overwhelming" creditor support; most acceptances already solicited); *In re Pine Run Trust*, 67 B.R. at 435 (court found that "traditional ground" of large size not established); *In re United Press Int'l*, 60 B.R. at 271 n.12 (modifications of exclusivity already granted to certain parties).

paid in full in cash by no later than the first quarter of 2003 and avoids the unnecessary and costly legal battle to preempt a century of state laws and regulations. In addition, it gives the Commission a voice in PG&E's restructuring, which to date it has been denied by PG&E. Creditors that are not interested in joining PG&E's preemption bandwagon should be given the option not to. Denying PG&E's Second Extension Motion to allow the Commission to file its Alternate Plan gives them that option.

Moreover, modifying PG&E's plan exclusivity to permit the Commission to file its Alternate Plan comes without cost to PG&E. PG&E may still pursue confirmation of its Plan should it choose to do so. In addition, notwithstanding PG&E's unsupported rhetoric to the contrary, the requested modification of PG&E's exclusive period would not "create needless confusion and conflicts that will presumably prejudice all parties." PG&E's Sec. Ext. Mot. at 4. This Objection is limited in that it seeks only to open up the plan process to the Commission's Alternate Plan — the Commission is not advocating that it be opened up generally to all parties in interest. Courts in similar situations have recognized that allowing competing plans may be efficient and can be used as an appropriate means of facilitating reorganization. *See In re Interco, Inc.*, 137 B.R. 999, 1001 (Bankr. E.D. Mo. 1992) (noting that "simultaneous consideration of competing plans may be an efficient procedure"); *PSNH*, 88 B.R. at 539 n.16 (rejecting an argument similar to PG&E's; "If taken literally, the debtor's position would mean that the debtor must have the sole power to present a plan, because multiple plans will bring chaos; therefore, the debtor's exclusivity period must be continued indefinitely."); *In re United Press Int'l*, 60 B.R. at 271 n.12 (justifying the "middle course" taken in an earlier decision to modify exclusivity to allow parties the opportunity to present plans and at the same time prevent the disturbance to the process that may result from terminating exclusivity entirely);[13] *In re*

[13] Specifically, the *United Press* court offered the following rationale for its approach: "Thus, this Court adopted a middle approach, initially suggested by the parties themselves – opening up the right to file a plan on a limited basis to those two entities (besides the Debtor itself) that have the most at stake in this case and have shown themselves to be responsible parties, while refraining from opening the floodgates completely. The statute does not expressly prohibit this eminently sensible middle course, and I can perceive no reason to find any such prohibition by implication." *United Press*, 60 B.R. at 271 n.12.

Texaco, 81 B.R. at 808 (Bankr. S.D.N.Y. 1988) (referring to earlier ruling from bench that "it would be willing to terminate the exclusivity periods on motion if the statutory committees and . . . [the debtor's principal adversary] could agree unconditionally to a base/cap plan, provided that Texaco was given an opportunity to have input with respect to the negotiations").

Finally, if PG&E's concerns about ensuing chaos have merit, then this Court can construct adequate procedural safeguards to address such concerns. *See PSNH*, 99 B.R. at 177.

In sum, PG&E's threats of "chaos" are sufficiently remote and capable of being addressed so as not to warrant exclusion of the Commission's Alternate Plan.

V.

CONCLUSION

For the reasons set forth herein and in the Cohen Declaration, the Commission respectfully requests that this Court deny PG&E's Second Extension Motion to the extent necessary to permit the Commission to file its Alternate Plan and solicit acceptances thereto.

DATED: January 8, 2002

Respectfully submitted,

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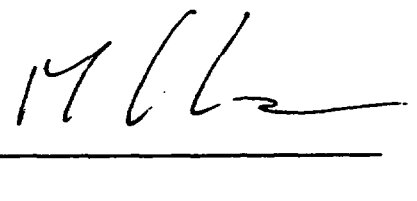
CALIFORNIA PUBLIC UTILITIES COMMISSION

By: 

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UNITED STATES BANKRUPTCY COURT

NORTHERN DISTRICT OF CALIFORNIA

SAN FRANCISCO DIVISION

In re	Case No. 01-30923 DM
PACIFIC GAS AND ELECTRIC COMPANY, a California corporation,	Chapter 11 Case
Debtor.	**THE COMMISSION'S MEMORANDUM IN FURTHER SUPPORT OF ITS OBJECTION TO PROPOSED DISCLOSURE STATEMENT FOR PLAN OF REORGANIZATION UNDER CHAPTER 11 OF THE BANKRUPTCY CODE FOR PACIFIC GAS AND ELECTRIC COMPANY**
Federal I.D. No. 94-0742640	Date: January 25, 2002 Time: 9:30 a.m. Place: 235 Pine Street, 22nd Floor, San Francisco, California

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PRELIMINARY STATEMENT

PG&E's proposed Plan and Disclosure Statement have little to do with the traditional bankruptcy goal of adjusting debtor-creditor relationships and other interests in

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property of the debtor. Instead, the centerpiece of PG&E's proposed plan is its attempt to obtain unprecedented and sweeping relief against the Commission and the State of California enjoining them from exercising their sovereign regulatory authority. PG&E has not proposed a normal plan of reorganization; it has proposed a plan of preemption and deregulation. PG&E asks the Court to order that PG&E, unlike all other integrated public utilities in this country, need not comply with applicable state statutes, state regulations, and state regulatory authority.

The Court should not approve PG&E's Disclosure Statement because it describes a Plan that is unconfirmable on its face, for at least two independent reasons:

1. No Preemption. According to PG&E, section 1123(a)(5) of the Bankruptcy Code evinces Congressional intent to sweep aside virtually all state regulatory authority over public utilities that file for bankruptcy. But Congress intended nothing of the kind. Section 1123(a)(5) provides that "[n]otwithstanding any otherwise applicable nonbankruptcy law, a plan shall . . . provide adequate means for the plan's implementation . . . ." On its face, this language refers to the contents of a plan, and preempts nonbankruptcy laws that might otherwise regulate the content of the plan, such as securities-related laws that might otherwise require more disclosure in the plan than is mandated by the Bankruptcy Code. Section 1123(a), read naturally, does *not* provide for express preemption of nonbankruptcy laws regulating transactions contemplated by the provisions of a proposed plan. Nor could Congress reasonably have intended that the phrase "notwithstanding any otherwise applicable nonbankruptcy law" would confer upon the bankruptcy court the discretion or authority to authorize violations of state or federal nonbankruptcy law, civil or criminal, merely because the debtor has indicated its intention to violate those laws in its plan.

The legislative history of section 1123(a)(5) shows that the "notwithstanding" phrase was added in 1984 as a technical amendment that was *not* intended to alter the prior scope of the law. Furthermore, the "notwithstanding" phrase derives from a provision in a 1980 bill that was described in a Report of the House Judiciary Committee in a way that squarely supports the Commission's reading of the text, and is completely irreconcilable with PG&E's. Under

applicable case law, which was left unaffected by enactment of the "notwithstanding" phrase, the extent to which provisions of a proposed plan may displace otherwise applicable state law is governed by principles of *implied* preemption. The backdrop for those principles includes presumptions that militate strongly against preempting state regulatory law. *See Medtronic, Inc. v. Lohr*, 518 U.S. 470, 485 (1996).

In keeping with these principles, the Ninth Circuit ruled in *Baker & Drake Inc. v. Public Service Commission of Nevada*, 35 F.3d 1348 (9th Cir. 1994), that the Bankruptcy Code does not preempt state statutes or regulations intended to protect the public safety and welfare. According to the Ninth Circuit, state statutes may be preempted by the Bankruptcy Code only if, at a minimum, they are directed solely at economic regulation, narrowly understood, and if certain other factors apply. The provisions of the Public Utilities Code that PG&E seeks to preempt protect the public safety and welfare, and accordingly preemption cannot occur. That would be true even if enforcement of the challenged provisions of state law would make a bankruptcy reorganization more difficult, or even impossible.

Here, however, that is not the case. As the Commission states in its objection to PG&E's second request for an extension of its plan exclusivity, which the Commission is also filing today, the Commission has formulated an alternative plan. With the Court's permission, the Commission intends to propose that plan. The Commission's plan does not require preemption of state regulatory law, maintains adequate safeguards for the safety and welfare of California citizens, and provides PG&E's creditors with payment in full in cash (including accrued interest through the plan's effective date). Preemption is not even necessary here, and that is an additional reason why it is impermissible.

2. Sovereign Immunity. The Eleventh Amendment and related principles of sovereign immunity will bar requests for relief against a state or state agency, whether sought in an adversary proceeding or by way of a chapter 11 plan, that have the practical effect of constituting "the prosecution, or pursuit, of some claim, demand, or request . . . in a court of justice." *Cohens v. Virginia*, 19 U.S. (6 Wheat) 264, 407 (1821) (Marshall, C.J.). Here, the

relief PG&E demands in its proposed plan is just such a "claim, demand, or request" against the State of California. PG&E demands sweeping declaratory, injunctive, and the functional equivalent of monetary relief against the Commission and the State of California. These demands for relief are doubly offensive to the sovereignty of the State. First, the demands are aimed specifically and purposefully at the Commission and the State in their capacities as sovereign regulator; PG&E is not requesting relief against the Commission or the State as ordinary creditors. Second, PG&E's demands for relief seek to bar the Commission and the State from exercising sovereign powers that are absolutely fundamental to the State's regulatory authority over PG&E, a public utility, and consequently to the safety and welfare of the citizens of California.

STATEMENT OF FACTS

In its proposed plan, PG&E demands sweeping declaratory and injunctive relief against the Commission and its sovereign regulatory authority. PG&E's proposed plan seeks to dislodge the Commission's regulatory jurisdiction to review, for compliance with California law, the four main transactions through which PG&E will separate its current business into ETrans, GTrans, Gen, and the Reorganized Debtor.[1] In this way, PG&E hopes to push through a series of transactions that, in their current form, could not reasonably be expected to survive the scrutiny of the Commission and its experts. PG&E also demands that the Bankruptcy Court retain jurisdiction over several critical aspects of the operations of the proposed Reorganized Entities, even after PG&E emerges from bankruptcy. In essence, PG&E would have this Court remain on as a "super-regulator" to review and manage the relationship between PG&E, the Commission, and ratepayers in California.

As set forth at greater length in the accompanying declaration of Loretta M. Lynch, President of the Commission, the state statutes and regulations that PG&E seeks to preempt constitute the heart of the Commission's regulatory authority over public utilities like

[1] Capitalized terms not defined herein shall have the meanings ascribed thereto in PG&E's First Amended Disclosure Statement ("Am. Discl. Stmt.").

PG&E, and reflect sovereign determinations of the State of California that balance the competing interests of regulated public monopolies and those of the citizens of the State.

The statutes and regulations that PG&E seeks to preempt are not merely "economic" in the sense that they primarily generate revenue or taxes for the State, or are primarily concerned with other economic or debtor-creditor matters. Rather, these statutes and regulations directly further the State's police power and sovereign obligation to provide for the safety and welfare of its residents. For example, PG&E demands that section 451 of the Public Utilities Code be preempted. That section, together with other provisions of California law, establishes PG&E's fundamental "obligation to serve," which requires PG&E to provide electricity at all times to every ratepayer within its service area.[2] PG&E demands that the Bankruptcy Court preempt PG&E's obligation to serve and replace it with a new regulatory regime of PG&E's own making, under which the Bankruptcy Court would retain jurisdiction indefinitely to regulate and oversee the relationship between PG&E and its customers. *See* Am. Discl. St. at 112.

Similarly, public safety and welfare would be compromised if the Court preempted, as PG&E demands, state laws that require Commission review and approval before a public utility may enter into certain transactions that affect its ownership and control, financial integrity, or ability to carry out its functions. (Lynch Decl. ¶¶ 34-37.)

As a regulated public monopoly, of course, PG&E does not have the same freedom concerning its property and operations that a purely private company does. In exchange, PG&E enjoys the considerable advantages of being a public monopoly. The purpose

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[2] *See* Cal. Pub. Util. Code §§ 451, 761, 762, 768, 770 (2002); *see also Interim Order Affirming the Obligation to Serve and Issuing Temporary Restraining Order*, PUC Dec. 01-01-046 dated Jan. 19, 2001, at 1-2 ("We affirm that regulated California utilities must serve their customers. This requirement, known as the 'obligation to serve,' is mandated by state law. A utility's obligation to serve is part and parcel of the entire regulatory scheme under which the Commission regulates and controls utilities under the Public Utilities Act."); *id.* at 7, 16 ("State law clearly requires utilities to serve their customers"; "[u]nder Public Utilities Code sections 451, 761, 762, 768 and 770, PG&E . . . [has] an obligation to provide full and adequate service to all of [its] customers . . . ."; opinion discusses basis in California statutes and regulatory decisions for PG&E's duty to serve).

of requiring Commission review of transaction involving regulated public monopolies is to ensure that the monopolies do not enter into transactions, such as many of the transactions that PG&E proposes here, that threaten their ability to serve their customers, have an adverse environmental impact, or that have the potential to harm the public interest. (*Id.* ¶¶ 34-35.)

For example, PG&E demands that the Commission's Affiliate Transaction Rules be preempted. (*See* Am. Discl. St. at 112.) These rules establish certain limits and Commission oversight of the transactions and relationship between public utilities and their affiliates. The State has an obvious and strong interest in limiting the scope of the monopoly it grants to public utilities in exchange for the utilities' undertaking to serve. These provisions and rules prevent a public utility from abusing its self-dealing relationship with subsidiaries and affiliates in competition, and otherwise acting to the detriment of the public. (Lynch Decl. ¶¶ 47-48.)

To make matters worse, several of the critical transactions that PG&E now seeks to accomplish were in substance considered by the Commission prior to PG&E's bankruptcy, and were rejected because the proposed transactions would have been detrimental to public safety and welfare. For example, in 1994 PG&E indicated an intention to change the jurisdictional status of its California natural gas transmission and storage systems into "interstate" facilities, subject to regulation by FERC rather than by the Commission. The Commission determined, however, that the transactions contemplated would have potential adverse impacts and were not in the public interest. (*Id.* ¶¶ 7-8, 44-46.) Such adverse impacts included "the possibility that the Commission will be unable to ensure the provision of base service to homes, schools and hospitals in the case of a supply or capacity crisis; the possibility that the pricing of gas service for captive customers will undermine the universal availability of affordable gas service for California citizens; the possibility that pricing of gas service for captive customers will necessitate the widespread use of alternative fuels, thereby creating adverse impacts on the environment." (*Id.* ¶ 8.)

Similarly, in 1999 PG&E asked the Commission to approve a proposal to break its massive hydroelectric system into a number of lots, or "bundles," and auction those bundles

off in the market to the highest bidder. But a draft Environmental Impact Report prepared for the Commission by independent consultants showed that the proposal would have significant adverse environmental consequences. (*Id.* ¶¶ 9-11 & Ex. A.)

The laws and rules that PG&E would have this Court preempt are vital to public safety and welfare in the State of California and constitute the heart of the Commission's sovereign regulatory authority. They should not be preempted.

ARGUMENT

The Court should not approve PG&E's Disclosure Statement because it describes a Plan that is unconfirmable on its face. *See In re Silberkraus*, 253 B.R. 890, 899 (Bankr. C.D. Cal. 2000) ("There are numerous decisions which hold that where a plan is on its face nonconfirmable, as a matter of law, it is appropriate for the court to deny approval of the disclosure statement describing the nonconfirmable plan.").[3]

I.

PG&E'S PROPOSED PLAN IS UNCONFIRMABLE BECAUSE IT DEMANDS DECLARATORY AND INJUNCTIVE RELIEF THAT THE BANKRUPTCY COURT CANNOT GRANT

It appears that PG&E seeks to avoid the effect of a multitude of state statutes and regulations on the grounds that those statutes and regulations are preempted by section 1123(a)(5) of the Bankruptcy Code. That section, which is contained in the section of the Bankruptcy Code governing the description of plan contents, provides in relevant part:

> (a) Notwithstanding any otherwise applicable nonbankruptcy law, a plan shall
>
> . . .
>
> (5) provide adequate means for the plan's implementation such as—

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[3] Pursuant to the Court's Order of December 5, 2001, this Memorandum sets forth only the Commission's arguments that the Proposed Amended Plan cannot be confirmed as a matter of law (and that the Proposed Amended Disclosure Statement therefore cannot be approved), because the plan rests on a misapprehension of the preemptive effect of the Bankruptcy Code and would violate California's sovereign immunity if confirmed. The Commission expressly preserves all of the arguments previously set forth, and to be raised hereafter, in support of its Objection, including its other arguments that the Proposed Amended Plan cannot be confirmed.

(A) retention by the debtor of all or any part of the property of the estate;

(B) transfer of all or any party of the property of the estate to one or more entities, whether organized before or after the confirmation of such plan;

(C) merger or consolidation of the debtor with one or more persons;

(D) sale of all or any part of the property of the estate, either subject to or free of any lien, or the distribution of all or any part of the property of the estate;

(E) satisfaction or modification of any lien;

(F) cancellation or modification of any indenture or similar instrument;

(G) curing or waiving of any default;

(H) extension of a maturity date or a change in an interest rate or other term of outstanding securities;

(I) amendment of the debtor's charter; or

(J) issuance of securities of the debtor, or of any entity referred to in subparagraph (B) or (C) of this paragraph, for cash, for property, for existing securities, or in exchange for claims or interests, or for any other appropriate purpose.

PG&E evidently takes the position that, by enacting this section of the Bankruptcy Code, Congress intentionally swept aside virtually all state regulatory authority over public utilities that file for bankruptcy.[4]

Congress intended nothing of the kind. Construing section 1123(a)(5) in the manner PG&E proposes, in order to hold that the State of California is powerless to enforce its sovereign regulatory authority over a public utility, would stretch the section beyond recognition. Where the Ninth Circuit has had occasion to address similar, albeit far more modest, efforts to misuse the Bankruptcy Code in this way, it has declined to accept any such overbroad interpretation. *See Baker & Drake*, 35 F.3d 1348 (9th Cir. 1994).

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[4] PG&E does not want to preempt all state laws regarding public utilities, only those that it does not like. For example, while PG&E demands that the Court order that just about every state law that imposes any burden or inconvenience on PG&E be preempted, PG&E nevertheless contends that another section of the Public Utilities Code should remain in full force and effect, because, as PG&E reads that section, it imposes a burden on the Commission to market value PG&E's non-nuclear facilities. (Am. Discl. Stmt. at 131 n.19.)

A. Section 1123(a)(5) Does Not Authorize Preemption of the State Regulatory Laws That PG&E Seeks to Avoid

The Supreme Court has classified two general categories of preemption: express preemption and implied preemption. Express preemption occurs when Congress clearly indicates its intent to preclude state regulation in a given area. *See, e.g., Cipollone v. Liggett Group, Inc.*, 505 U.S. 504, 517 (1992). Implied preemption refers to a situation in which Congress, through its legislation, has by implication prohibited certain state regulation in a given area. *See, e.g., Buckman Co. v. Plaintiffs' Legal Comm.*, 531 U.S. 341, 348 (2001). Neither of these categories of preemption applies to the state statutes and regulations PG&E contends are preempted.

1. Section 1123(a)(5) Governs the Required Contents of a Plan, Not the Substantive Legality of the Transactions Described in the Plan

Section 1123(a), which is entitled "Contents of plan," lists features that a debtor is required to include in any proposed plan. The text of section 1123(a) imposes a duty on the proponent to include the enumerated mandatory plan provisions in any proposed plan—"[n]otwithstanding any otherwise applicable nonbankruptcy law" that might excuse the debtor from this duty or impose inconsistent duties concerning the mandatory contents of a plan. Subsection 5 of section 1123(a), on which PG&E evidently relies here, provides that a plan shall "provide adequate means for the plan's implementation . . . ." Thus, if a debtor fails to set forth, in the proposed plan, adequate means of implementation, the debtor's failure demonstrates a lack of good faith under section 1129(a)(5) and precludes confirmation of the plan.[5] Section 1123(a)(5) does *not*, however, say or mean that "notwithstanding any otherwise applicable nonbankruptcy law," the debtor may take any action that arguably constitutes "adequate means for the plan's implementation," regardless of whether the means selected or the plan provision to be implemented violate the criminal or civil statutes of the United States or one or more of the States. Any such interpretation would be inconsistent with the natural meaning of

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[5] *See Crestar Bank v. Walker (In re Walker)*, 165 B.R. 994, 1003-04 (E.D. Va. 1994) (collecting cases).

the text and, in particular, with the natural meaning of the "notwithstanding" phrase at the outset of section 1123(a).

An analogy may clarify the point. If a hypothetical statute stated "the plan must demonstrate how it will be funded," that mandate would not entitle the proponent to declare that it intended to steal the money. The requirement on its face would go to the required contents of the plan, and would not address the legality of the proposed method of funding. And if the hypothetical statute stated "notwithstanding any otherwise applicable nonbankruptcy law, the plan must demonstrate how it will be funded," the result would be the same. The "notwithstanding" phrase, read naturally, would mean that the proponent must formulate and disclose a proposed method of funding, notwithstanding any other law that might limit, modify, or expand the duty to formulate and disclose such a method. It would still not mean that the plan could be funded through theft or other violations of nonbankruptcy law. For the same reasons, actual subsection 1123(a)(5) means that a plan proponent has a duty, not subject to abolition or qualification under otherwise applicable nonbankruptcy law, to formulate and disclose adequate means for implementation. Section 1123(a)(5) does *not* mean that the debtor, in the process of implementation, may freely violate any and all nonbankruptcy laws.

This textual analysis does not, of course, mean that a plan may never displace any provision of otherwise applicable nonbankruptcy law. Section 1123(a) does not expressly address what happens if the plan proposes an action that is substantively inconsistent with nonbankruptcy federal or state law. It leaves that problem, in the absence of an applicable provision for express preemption elsewhere in the Code, to principles of *implied* preemption that have been developed through many years of bankruptcy case law, and that historically have proven adequate to the delicate problem of reconciling bankruptcy-related interests and interests arising from nonbankruptcy federal and state law. In this Circuit, the definitive and controlling exposition of those principles is the Ninth Circuit's decision in *Baker & Drake*, which is discussed below.

The structure, legislative history, and overall purpose of section 1123(a) support the Commission's reading. As to structure, subsections of section 1123(a) other than subsection 5 focus on commands *to the plan proponent* that it include various features in the proposed plan. More specifically, subsections (1) through (3) require designation of classes of claims, and specification of claims or interests that are not impaired or are impaired. Subsection (4) commands the proponent to provide the same treatment for each claim or interest of a particular class, absent consent by the relevant holder. Subsection (6) contains mandatory provisions for the charter of a corporate debtor or successor entity. And subsection (7) provides that plan provisions governing the selection of certain fiduciaries must be consistent with the interests of creditors and equity security holders and with public policy.

These provisions all either direct the proponent to include features in the proposed plan, or, as to subsection (7), limit the scope of certain plan provisions. Subsection (5) should be read in the same way: it requires the proponent to explain why the proposed plan is workable by showing that the plan "provide[s] adequate means for . . . implementation." Subdivisions (A) through (J) of subsection 5 specify particular actions that the proponent may include in its proposals for implementation. And the requirements set forth in section 1123(a), including that of subsection 5, are binding on the proponent "notwithstanding any otherwise applicable nonbankruptcy law" that might be read to limit (or, evidently, to expand) those requirements.[6]

PG&E's view also results in a misfit between section 1123 and section 1142(a) of the Code. Under section 1142(a), "[n]otwithstanding any otherwise applicable nonbankruptcy law, rule, or regulation *relating to financial condition*, the debtor . . . shall carry out the plan . . . . (Emphasis added.) The obvious negative pregnant arising from section 1142(a) is that a debtor, in carrying out a plan, must generally abide by otherwise applicable non-bankruptcy law that

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[6] *FCX, Inc. v. Universal Cooperatives, Inc.*, 853 F.2d 1149, 1155 (4th Cir. 1988), reads § 1123(a)(5) as an "empowering statute," in the sense that it authorizes a proponent to propose steps that may enlarge the debtor's prebankruptcy rights. That terminology is consistent with the Commission's view that a plan may preempt state law only in the circumstances identified in *Baker & Drake*.

does *not* relate to financial condition. That negative pregnant, and indeed the necessity for this portion of section 1142(a), would be overridden if, as PG&E evidently contends, section 1123 immunizes a debtor from any duty to comply with *any nonbankruptcy law at all* in carrying out the provisions of the plan.[7]

This reading finds further support in the legislative history of the statute that added the phrase "[n]otwithstanding any otherwise applicable nonbankruptcy law" to section 1123(a). That phrase was not included in section 1123(a) as enacted in the Bankruptcy Code of 1978. The phrase apparently first appeared in S. 658 as submitted by the House Judiciary Committee to the House in July 1980. The Judiciary Committee proposed to amend section 1123(a) in relevant part as follows. (The Judiciary Committee indicated deleted language in bold brackets, added language in italics, and unchanged language in roman type.)

> (a) **[A]** *Notwithstanding any otherwise applicable nonbankruptcy law, a* plan shall-- . . . .
>
> (5) provide adequate means for the plan's **[execution]** *implementation*, such as-- . . . .

An Act to Correct Technical Errors, Clarify and Make Minor Substantive Changes to Public Law, Pub. L. No. 95-598, S. 658, 96th Cong., 2d Sess. (1980), H.R. Rep. No. 96-1195, 96th Cong., 2d Sess. 122-23 (July 25, 1980) (hereinafter "H.R. Rep. No. 96-1195," Ex. A Tab 1).[8]

Two points concerning the Report of the House Judiciary Committee are highly significant. First, the Judiciary Committee's comments on section 102(a) of the proposed legislation (which contained the proposed amendment to section 1123(a)) in the section-by-section analysis read as follows:

> *This amendment makes clear that the rules governing what is to be contained in the reorganization plan are those specified in this section*; deletes a redundant word; and makes several stylistic changes.

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[7] In commenting on section 1142, *Collier on Bankruptcy* notes that "if the plan called for a transfer of a broadcast license . . ., an order implementing confirmation should not allow the debtor to evade the necessary regulatory process for obtaining such a transfer." 8 Lawrence P. King, *Collier on Bankruptcy* ¶ 1142.03[2] (2001).

[8] Copies of the relevant portions of the legislative history cited herein are contained in a Legislative History Appendix attached hereto as Exhibit A.

H.R. Rep. No. 96-1195, at 22 (emphasis added) (Ex. A Tab 2).

Thus, according to the Judiciary Committee, the "notwithstanding" phrase was added to clarify that "*this section*"—i.e., section 1123(a)—definitively states "the rules governing what is to be contained in the reorganization plan."[9] The phrase "[n]otwithstanding any otherwise applicable nonbankruptcy law" fits with that purpose *only* if the phrase is understood to mean that otherwise applicable nonbankruptcy law is ineffective to vary the specification in section 1123(a) of the mandatory provisions of a proposed plan. In other words, nonbankruptcy law is ineffective to excuse a debtor from including all mandatory elements in the proposed plan, and is evidently ineffective to require the inclusion of additional elements. That is exactly the reading that the Commission gives to section 1123(a).

Second, the Report of the House Judiciary Committee is completely inconsistent with the revolutionary significance that PG&E apparently attributes to the "notwithstanding" phrase. PG&E's proposed plan, which calls for wholesale preemption of California regulatory law, appears to rest on the assumption that under the "notwithstanding" phrase, a bankruptcy court has unlimited discretion to preempt state regulatory law that prohibits either transactions contemplated by a restructuring or certain post-restructuring activities. If the "notwithstanding" phrase of section 1123(a) had been intended to effect such a revolutionary change, notwithstanding the patent inadequacy of the text for this purpose, one would at least expect documentation in the legislative history of this amazing new development. To the contrary, however, the Report of the House Judiciary Committee treats this amendment to section 1123(a) as entirely mundane.

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[9] Examination of all the amendments to section 1123 proposed by S. 658, as reported by the House Judiciary Committee, discloses that the first portion of the section-by-section analysis (which is italicized in the block quotation above in text) could refer *only* to the addition of the "notwithstanding" phrase. A complete copy of those proposed amendments to section 1123 appears as Exhibit A, Tab 3, to the Legislative History Appendix. *See* An Act Correcting Technical Errors and Making Minor Substantive Changes to Public Law 95-598, S. 658, 96th Cong., 2d Sess. 1980, *reprinted in* 30 Bankr. L. Rep. 83, 198 (CCH) (Nov. 20, 1980) (text of amendment to statute) (Ex. A Tab 3).

In its introduction to that Report, the House Judiciary Committee noted that technical amendments were required to correct "[e]rrors in printing, spelling, punctuation, grammar, syntax, and numeration . . . ." H.R. Rep. No. 96-1195, at 1 (Ex. A Tab 4). Though "[s]uch matters [constitute] the vast majority of the Technical Amendments Act," some items of a substantive nature were also said to be included. *Id.* at 2. The Report listed general areas in which substantive changes were made, none of which embraced the subject matter of section 1123(a). *See id.* at 2-5 (Bankruptcy Judge's Retirement); 5-6 (Municipal Financing), 6-7 (Stockbroker/Commodity Broker Liquidation), 7-8 (Tax Provisions).

In December 1980, the House passed S. 658 by unanimous consent with additional amendments. *See* S. Rep. No. 98-65, 96th Cong., 1st Sess., Calendar No. 102, at 51 (chronicling legislative history) (hereinafter "S. Rep. No. 98-65," Ex. A Tab 6). The Senate reintroduced the bill as S. 3259 and passed it unanimously. *Id.* at 51-52. The House, however, took no action on the final Senate changes, and consequently the bill was never enacted into law. *Id.*

The remaining legislative history for the "notwithstanding" phrase confirms that it was not intended to have the meaning apparently attributed to it by PG&E. On April 2, 1981, three Senators introduced S. 863, which incorporated all of the provisions of S. 3259 (including the "notwithstanding" amendment to section 1123(a)). *See* Bankruptcy Amendments Act of 1981, S. 863, 97th Cong., 1st Sess. (1981), S. Rep. No. 97-150, 97th Cong., 1st Sess. at 2 (July 10, 1981) (Ex. A Tab 7). After hearings on April 3 and 6, 1981, during which no statements appear to have been made concerning proposed amendments to section 1123(a), the Senate Judiciary Committee reported S. 863 to the Senate. *Id.* In the section-by-section analysis of its report, the Judiciary Committee described the proposed to amend section 1123(a) as follows:

> Paragraphs (1) through (5) make technical stylistic changes. Paragraph (6) makes clear that preferred stock without voting rights can be issued under the plan and the prohibition against issuing stock that cannot be voted extends only to common stock.

Id. at 15, Ex. A Tab 8.

The Senate passed S. 863, but the House did not consider it. S. Rep. No. 98-65, at 52 (Ex. A Tab 9). Accordingly, the bill was not enacted. Then, in 1983, S. 455 was introduced in the Senate. S. Rep. No. 98-65, at 1. S. 455 contained numerous technical amendments and certain substantive amendments. The technical amendment section of S. 455 contained the proposed amendment to section 1123(a) with the "notwithstanding" phrase. S. Rep. No. 98-65, at 51-53 (Ex. A Tab 10). The Senate Judiciary Committee submitted S. 455, with the amendment to section 1123(a), to the Senate. S. Rep. No. 98-65, at 2. The amendment to section 1123(a) was contained in Subtitle I, entitled "Technical and Clarifying Amendments," of the bill as reported. The summary section of the accompanying Committee Report noted that:

> [T]he bulk of the provisions in this subtitle [I] are drawn from S. 863 [the 1981 predecessor bill], which passed the Senate by unanimous consent in 1981. The provisions correct grammatical, punctuation and spelling errors in the code, clarify the intent of the drafters in certain sections, and generally refine procedures.

S. Rep. No. 98-65, at 52-53 (Tab 11).

The section-by-section analysis in the Committee Report reiterated that the amendment to section 1123(a) "make[s] technical stylistic changes." *Id.* at 84 (Tab 11).[10]

S. 455 was ultimately incorporated in S. 1013, which in turn formed the basis for a Conference Committee appointed to reconcile differing bankruptcy legislation passed by the Senate and the House. The bill reported by the Conference Committee contained the amendment to section 1123(a) that included the "notwithstanding" phrase. The Conference Report contained only the text and did not explain its contents. *See* Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. No. 98-353, 98th Cong., 2d Sess. (1984), H.R. Conf. Rep. No. 98-882 (June 29, 1984) *reprinted in* Arnold & Porter Legislative History: Pub. L. No. 98-353 at *55 (Tab 13). A concurrently issued document entitled *Statements by Legislative Leaders* did discuss the bill, but that document made no mention of the amendment to section 1123(a). *See* Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L.

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[10] A complete copy of the proposed amendments to section 1123 appears at Tab 12 to the Legislative History Appendix.

No. 98-353, *Statements by Legislative Leaders, reprinted in* 1984 U.S.C.C.A.N. 576-606 (Tab 14). Both the Senate and the House passed the bill proposed by the Conference Report, again without discussion of the provision pertinent here, and the President signed it into law on July 10, 1984. *See* Bankruptcy Federal Judgeship Act, Pub. L. No. 98-353, 98 Stat. 333 (Tab 15). This legislative history, which uniformly treated the amendment to section 1123(a) as technical and mundane, squares perfectly with Commission's reading of the statute and is impossible to reconcile with PG&E's.

The Commission's reading also makes sense in light of the purposes of section 1123(a) and the nuanced overall approach taken by Congress in the Bankruptcy Code and elsewhere to reconciling interests arising from bankruptcy law and interests arising from nonbankruptcy federal and state law. That approach is reflected in provisions such as section 362(b)(4) of the Bankruptcy Code (the police and regulatory powers exception to the automatic stay) and section 959(b) of the Judicial Code (requiring debtors in possession to comply with valid state laws). On the Commission's view, section 1123(a) requires and authorizes the plan proponent to include certain features in a proposed plan. The section does not directly speak to whether a bankruptcy court may confirm a plan calling for actions inconsistent with applicable nonbankruptcy law; rather, that problem is left to traditional case-by-case adjudication under principles of implied preemption.

PG&E, in contrast, apparently views section 1123(a) as an engine of destruction for federal and state laws that, in the view of a plan proponent, stand in the way of a desired reorganization or of desired post-reorganization activities. PG&E's proposed plan implausibly assumes that Congress conferred unfettered discretion on plan proponents and bankruptcy courts to abrogate rights under federal and state law.

2. At Most, Section 1123(a)(5) Merely Codifies General Principles of Implied Preemption, as Set Forth by the Ninth Circuit in *Baker & Drake*

As explained above, the Commission does not view the "notwithstanding" phrase in section 1123(a) as preempting nonbankruptcy laws that would otherwise prohibit proposed actions to be taken pursuant to a plan. That phrase, in the Commission's view, displaces only

nonbankruptcy laws that might otherwise regulate the contents of the plan. If, however, the Court does not accept this view, the Court will need to formulate principles limiting the scope of any express preemption flowing from the "notwithstanding" phrase.

The appropriate limiting principles here are those developed in implied preemption cases and set forth in *Baker & Drake*. That interpretation gives appropriate respect to the uniform treatment in the legislative history of the "notwithstanding" phrase as technical and non-substantive. That interpretation also appropriately reconciles this provision with other provisions of the Bankruptcy and Judicial Codes, as described above; with the approach of the case law before enactment of the "notwithstanding" phrase, which is surveyed in *Baker & Drake* and is appropriately considered in order to give meaning to this technical and clarifying change; and with applicable general presumptions and canons of construction, including the presumption that Congress is presumed not to displace state regulation in traditional areas of state concern and must be clear and explicit in order to do so. *See Medtronic*, 518 U.S. at 485.

There are only two alternatives to this interpretation of the "notwithstanding" phrase, should it be read as an express preemption provision applicable to nonbankruptcy laws that would otherwise prohibit proposed actions to be taken pursuant to a plan. One alternative would empower every bankruptcy judge in the country, if so urged by a plan proponent, to preempt any and all federal or state laws thought to impede a restructuring. As the Court has recognized, that cannot be the law. To use the Court's example, a bankruptcy court obviously lacks the authority to authorize a bankrupt liquor store to sell liquor to minors in violation of state law, even if the liquor store were to show that a restructuring would be impossible in the absence of that authorization, and even though sales of property of the estate are among the transactions enumerated in section 1123(a)(5)(D). The other alternative would be to say that Congress, by enacting the "notwithstanding" phrase as a technical change, intended to require the courts to make up entirely new limiting principles in this area, without any express guidance in the "notwithstanding" phrase itself and without being bound by prior case law, despite the

total absence of any Congressional intent to reject that case law. That, too, is not a plausible theory of Congress's intent.

3. The Scope of Preemption Sought by PG&E Is Inconsistent on its Face with the Ninth Circuit's Controlling Decision in *Baker & Drake*

In this Circuit, *Baker & Drake* is the controlling exposition of the extent to which a plan of reorganization may authorize the debtor to take actions in violation of state law. There, the debtor, which operated a taxicab company, proposed in its plan of reorganization to have the employee-drivers of its taxicabs become independent contractors who would lease their cabs from the debtor. This feature of the proposed plan would have diminished the debtor's tort liability for personal injury lawsuits arising from the operation of the cabs; would have reduced the debtor's insurance premiums; and would have eliminated the debtor's liability for payroll taxes. This feature of the plan, however, also violated an applicable Nevada administrative regulation, which prohibited the debtor from leasing its taxicabs. Nevada defended its regulation as intended to further the public convenience and safety, evidently by promoting the company's control over the operation of the taxicabs.

The bankruptcy court in *Baker & Drake* approved the plan of reorganization and enjoined the Nevada agency from enforcing its regulation against the reorganized debtor. Adopting an approach similar to that urged here by PG&E (albeit in circumstances where the preemption sought was far more limited than PG&E seeks here), the court ruled as follows:

> I'm setting the [state] law aside in this instance. I'm not applying it. The Constitution of the United States says that Congress shall prescribe bankruptcy laws. It has. It takes precedence in given situations, and I think this is one.

Baker & Drake, 35 F.3d at 1350 (quoting oral ruling of bankruptcy court).

The district court reversed the bankruptcy court's decision, and the Ninth Circuit affirmed the district court's decision. The Ninth Circuit, after surveying the case law, formulated the applicable inquiry as follows:

> As we view these cases, they suggest that federal bankruptcy preemption is more likely (1) where a state statute facially or purposefully carves an exception out of the Bankruptcy Code, or (2) where a state statute is concerned with economic regulation rather than with protecting the public health and safety. With these principles in mind, we first note that [the Nevada administrative regulation] makes no reference to the Bankruptcy Code, and that its subject matter

> is unrelated to the Bankruptcy Code. Second, while [the Nevada regulation] may not be as essential to the protection of health of health and safety as, for example, toxic waste laws, it was promulgated in part as a safety measure, and its substantive provisions do not facially belie that goal. On the contrary, the district court found that the regulation was reasonably designed to protect public safety.

Id. at 1353-54; *see also Commonwealth of Massachusetts v. First Alliance Mortgage Co. (In re First Alliance Mortgage Co.)*, 263 B.R. 99, 112 (9th Cir. BAP 2001).

Applying these principles to the facts of the case, the Ninth Circuit concluded emphatically and without hesitation that the plan of reorganization could not be confirmed. (The Ninth Circuit did not remand the case to the Bankruptcy Court, and therefore necessarily concluded that the plan of reorganization was unconfirmable *as a matter of law.*) The Ninth Circuit wrote as follows:

> The Bankruptcy Code does not preempt [the Nevada administrative regulation]. Nevada's ban on taxi leasing is a broadly applicable regulation, not an individual, discretionary agency decision directed only at [the debtor]. Moreover, [the regulation] is not just an economic regulation, but one reasonably intended to secure the public convenience and safety. More importantly, it does not directly conflict with the purposes of the Bankruptcy Code in any way which could be generalized beyond the particular facts of the present case. The fact that a particular debtor's Chapter 11 reorganization is made more difficult because of compliance with otherwise valid state regulation is not a sufficient basis to invoke preemption.[11]

The *Baker & Drake* decision gives appropriate weight and respect to the legislation of a sovereign State, and to the expertise of its regulators, in areas of public convenience and safety. A bankruptcy judge may be able to police the fairness of strictly and narrowly economic aspects of a bankruptcy reorganization. Bankruptcy courts, however, lack authorization or expertise to substitute their judgment for that of a State and its expert regulators in other areas of public policy, as the division drawn in *Baker & Drake* recognizes.

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[11] *Id.* at 1354-55. The *Baker & Drake* court also clarified that the principles of that case apply even when applicable state law would render a successful reorganization impossible. On that point, the Ninth Circuit wrote that "Congress's purpose in enacting the Bankruptcy Code was not to mandate that *every company* be reorganized *at all costs*, but rather to establish a preference for reorganizations, where they are legally feasible and economically practical. Thus, if compliance with [the Nevada regulation] were to render [the debtor] financially unable to reorganize, neither [the debtor] nor Nevada would thereby be violating any provision of the Bankruptcy Code." *Id.* at 1353-54 (emphasis in original).

The principles of *Baker & Drake* plainly render PG&E's proposed plan unconfirmable as a matter of law. PG&E seeks preemption of virtually the entire regulatory scheme of the California Public Utilities Code (and various other California laws) with respect to the transactions constituting the proposed reorganization, and it seeks preemption of fundamental provisions of the California Public Utilities Code with respect to PG&E's post-reorganization activities. The various provisions of the Public Utilities Code that regulate such activities are generally applicable to all electric utilities subject to state regulation. The Public Utilities Code is not to be equated to "an individual, discretionary agency decision directed only at [PG&E]." *Id.* at 1354.

Equally obviously, the Public Utilities Code in general, and in respects relevant here, is plainly a body of law "reasonably intended to secure the public convenience and safety." The fundamental mandate of the Commission is to insure the provision of services by regulated utilities to California citizens at just and reasonable rates. That mandate has economic components, but its scope goes vastly beyond economic regulation in the sense of that term relevant under *Baker & Drake*. Finally, the Public Utilities Code obviously "does not directly conflict with the purposes of the Bankruptcy Code in any way which could be generalized beyond the particular facts of the present case." *Id.* at 1354-55.

The facts of *Baker & Drake* involved preemption of a single regulation respecting the ownership of taxicabs. The Ninth Circuit nonetheless found the preemption sought to "constitute a much greater intrusion into state power" than was authorized by prior case law. *Id.* at 1354. The scope of preemption sought by PG&E so far surpasses the preemption sought in *Baker & Drake* as to make argument on the point ridiculous. Both the result in *Baker & Drake* on the facts and the principles laid down in that case render PG&E's proposed plan unconfirmable as a matter of law.

4. Background Principles of Preemption Demonstrate That Section 1123(a) Should Not Be Read to Authorize Preemption of State Law Protecting Public Safety and Welfare, Especially in an Area Traditionally Reserved to State Regulatory Authority

The states are independent sovereigns within the federal system, and a litigant seeking preemption thus must shoulder a difficult burden. *See Nat'l Warranty Ins. Co. RRG v. Greenfield*, 214 F.3d 1073, 1076-1077 (9th Cir. 2000). "In all preemption cases, and particularly those in which Congress has legislated . . . in a field which the States have traditionally occupied, we start with the assumption that the historic police powers of the States were not to be superseded . . . unless that was the clear and manifest purpose of Congress." *Medtronic*, 518 U.S. at 485; *see also Gen. Motors Corp. v. Tracy*, 519 U.S. 278, 304, 308-09 (1997); *Midlantic Nat'l Bank v. N.J. Dep't of Envir. Protection*, 474 U.S. 494, 506-07 (1986) (prohibiting abandonment of property by debtor where such action violates laws protecting public health and safety, despite absence of express limitation in the Bankruptcy Code on the abandonment power).

PG&E confronts these presumptions at their most vigorous. Not only was the Public Utilities Code enacted in an area that has traditionally been left to state control, it concerns one of the most important spheres of state police power, the regulation of public utilities. *See Ark. Elec. Coop. Corp. v. Ark. Pub. Serv. Comm'n*, 461 U.S. 375, 377 (1983).

5. PG&E's Position, Which Calls for Unprecedented Preemption of Core California Regulatory Law Protecting Public Safety and Welfare, Finds No Support in the Case Law

Universal Cooperatives, Inc. v. FCX, Inc., 853 F.2d 1149 (4th Cir. 1988), is consistent with the result for which the Commission contends here, and certainly does not support the massive and unprecedented preemption PG&E seeks. There, the debtor proposed to distribute certain collateral to a secured creditor in order to satisfy a claim secured by the collateral. The secured creditor, however, apparently had a right under its by-laws, which had been adopted pursuant to state law, to refuse to accept the collateral in satisfaction of the claim.

The Fourth Circuit held that the bankruptcy court nonetheless had the power to approve the specific transaction under challenge. That result is consistent with a reasonable application of the principles subsequently delineated in *Baker & Drake*. The debtor proposed the

distribution of collateral pursuant to section 1123(a)(5)(D). The displaced by-law concerned the particular creditor that had adopted it, and could reasonably be viewed as "economic," in the narrow sense, in character. This case is entirely different.

Public Service Co. of New Hampshire v. New Hampshire (In re Public Service Co. of New Hampshire), 108 B.R. 854 (Bankr. D.N.H. 1989), surveys some of the general issues raised here, but for numerous reasons does not provide the answers. In that case, the State of New Hampshire argued that the Bankruptcy Code did not and could not preempt any provision of New Hampshire law requiring the approval of the State's Public Utilities Commission for any transaction contemplated by the restructuring. The ultimate holding in *Public Service Co.* was limited to a finding that in principle, the Bankruptcy Code might, under appropriate circumstances, permit preemption of New Hampshire law. The court did not approve any particular plan of reorganization; it did not approve any particular proposed preemption of New Hampshire law; and it underscored that it had not provided "'carte blanche' for the debtor to run roughshod over all types of state regulatory processes both before and after confirmation of any plan of reorganization." 108 B.R. at 891. The opinion is therefore inconclusive concerning the extent to which a plan of reorganization may authorize a debtor to take actions in violation of otherwise applicable nonbankruptcy federal or state law. The proposed plan underlying the opinion was eventually abandoned, so the *Public Service Co.* proceeding never clarified this question.

The opinion does contain very extensive dicta on preemption. We note, in summary fashion, several reasons why those dicta are not controlling here. First, the *Public Service Co.* court viewed the preemption sought there as involving "only a possible transfer of economic regulatory jurisdiction as contrasted with the more acute situation where a transfer of state regulatory authority over health or safety matters is argued to be the effect of federal preemption." 108 B.R. at 859. The arguments and facts here are otherwise. Second, the New Hampshire bankruptcy court obviously demonstrated far less respect for state law than did the Ninth Circuit in *Baker & Drake*. The opinion in *Public Service Co.*, for example, speaks of the

"wisdom of Congress' intent to largely remove regulatory agencies from the 'restructuring' necessary in a complex reorganization case." 108 B.R. at 891. Rhetoric of this kind is impossible to square with the Ninth Circuit's adamant refusal in *Baker & Drake* to preempt the authority of a Nevada regulatory agency over a common carrier. Third, *Public Service Co.* extensively discussed and relied upon the district court's decision in *In re MCorp.*, 101 B.R. 483 (S.D. Tex.1989), *rev'd, vacated, and remanded*, 900 F.2d 852 (5th Cir. 1990), *aff'd in part and rev'd in part*, 502 U.S. 32 (1991), which the New Hampshire court said "involved a problem somewhat analogous to the question in the present case." 108 B.R. at 867. The Fifth Circuit, however, rejected the relevant portions of the district court's analysis in *MCorp.*, and the Supreme Court, in a unanimous decision (with one Justice not participating) rejected the district court's decision in its entirety. Fourth, *Public Service Co.* viewed the "notwithstanding" phrase of section 1123(a) as *unambiguously* preempting at least some nonbankruptcy law that would otherwise regulate the restructuring transactions (as opposed to the contents of the proposed plan)—a conclusion that the language of that phrase simply will not sustain. (*Supra* at 9-11.) On that flawed basis, the *Public Service Co.* court rejected inferences from the legislative history supporting a more restrained reading, although the court failed to consider the passage from the 1980 Report of the House Judiciary Committee, *see supra* at 13, that bears most directly on the meaning of this phrase.[12]

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[12] The *Public Service Co.* court also drew certain inferences respecting preemption from Congress's failure to reenact, in the 1978 Bankruptcy Code, prior sections 77B(e)(2) and 77B(f) of the Bankruptcy Act of 1898, as amended in 1934. Those sections provided, among other things, that a plan of reorganization for a utility regulated by a State could not be confirmed until the plan had been submitted to state regulatory authorities; the authorities had had an opportunity to suggest amendments or objections; and the judge had considered those amendments or objections at a hearing. After the hearing, confirmation was possible only if the judge was satisfied that the debtor had obtained appropriate authorizations, approvals, or consents of regulatory authorities. 108 B.R. at 863-64.

The inferences drawn by the court were not warranted. These subsections of the Bankruptcy Act created special federal rights and procedures. It is perfectly reasonable to say that Congress decided to withdraw these special federal provisions, leaving state regulatory authorities to their independent rights and powers under *state* law. Preemption of state law is certainly not to be presumed from Congressional withdrawal of special federal rights that extend beyond, and exist separately from, state law. To the contrary, the applicable presumptions weigh against finding preemption of state regulatory law.

In short, no case has ever authorized anything like the result PG&E seeks here: essentially total preemption of state law that would otherwise regulate the dismemberment of an enormous electric utility, and partial preemption of state law regulating the post-restructuring operations of the utility, in circumstances where ousting state authority could have grave consequences for the safety and welfare of California citizens.

6. Preemption Is Not Essential to a Successful Reorganization of PG&E and Accordingly Is Impermissible As a Matter of Law

At the very least, preemption of state law is impermissible if it is not essential to the consummation of a successful reorganization. *See Baker & Drake*, 35 F.3d at 1354-55. Preemption is not essential here. As the Commission states in its objection to PG&E's second request for an extension of plan exclusivity, the Commission has formulated an alternative plan that does not require preemption of state regulatory law, maintains adequate safeguards for the health and welfare of California's citizens, and provides PG&E's creditors with payment in full in cash (including accrued interest through the plan's effective date).

B. The State Regulatory Laws that PG&E Seek to Preempt Protect Public Safety and Welfare, and for That and Other Reasons Cannot Be Preempted

1. PG&E Impermissibly Seeks to Preempt State Regulation Affecting Public Safety and Welfare

In its proposed plan, PG&E seeks to preempt exactly the sort of state regulation affecting public safety and welfare that the Ninth Circuit held in *Baker & Drake* is not preempted by the Bankruptcy Code.

First, the regulations that PG&E seeks to preempt are "broadly applicable regulation[s], not an individual, discretionary agency decision directed only at" PG&E. *See*

Section 1129(a)(6) of the Code requires that prior to confirmation, regulatory authorities (whether federal or state) must have approved rate changes provided for in a plan, or that such rate changes must be "expressly" conditioned on approval. This provision protects the special bankruptcy interest in assuring that if the plan is funded through rate changes, either (i) that funding has been secured before confirmation through appropriate regulatory approvals, or (ii) the plan "expressly" notifies parties in interest that at the time of confirmation, those approvals have not yet been obtained. Section 1129(a)(6) therefore does not evidence any Congressional intent to abrogate federal or state regulation that protects nonbankruptcy interests.

Baker & Drake, 35 F.3d at 1354. All but a few of the regulations apply, at an absolute minimum, to all investor-owned public utilities in the State, including gas and electric utilities, water utilities, telecommunications utilities, and various transportation common carriers, not only PG&E. Moreover, most of the regulations apply to all public utilities, not just those which are investor-owned. In any event, there is no suggestion in *Baker & Drake* that a state regulation not of general applicability can necessarily be preempted. To the contrary, the focus in *Baker & Drake* was on whether the state regulation furthered public safety and welfare, and whether it directly conflicted with the Bankruptcy Code. *See also First Alliance*, 263 B.R. at 112.

Second, each of the regulations "is not just an economic regulation, but one reasonably intended to secure the public convenience and safety." *Id.* As explained in the Lynch Declaration, the state statutes and regulations that PG&E seeks to preempt not only are "reasonably intended" to secure public convenience and safety, they *directly* secure the State's sovereign police power to provide for the safety and welfare of its residents. (Lynch Decl. ¶¶ 25-55; *see supra* at 5.) At the very least, the state regulation at issue here no less secures public convenience and safety than the regulation which prohibited the debtor from leasing its taxicabs in *Baker & Drake*.

What is more, should PG&E succeed in preempting these statutes, the transactions proposed by PG&E would result in actual adverse effects to the safety and welfare of the public. As explained in the Lynch Declaration, the transactions PG&E proposes would have significant adverse effects to public health and safety, such as adverse environmental effects from the massive transfer of hydro and gas assets and nuclear facilities; the loss of in-state generation facilities that the State has determined, in its exercise of sovereign police power, are essential during the energy crisis and must remain dedicated to service for the benefit of the people of California; the potential that Commission will be unable to ensure the provision of basic service in the case of a supply or capacity crisis; the potential that the pricing of service for captive customers will undermine the availability of affordable service for California citizens and necessitate the widespread use of alternative fuels, thereby creating adverse impacts on the

environment; and the adverse effects to the safety and welfare of California residents through the loss of local regulation. (Lynch Decl. ¶¶ 8, 11-13, 24, 33-34, 40-46, 48-57.)

And finally, none of the statutes or regulations "directly conflict[s] with the purposes of the Bankruptcy Code in any way which could be generalized beyond the particular facts of the present case." *Baker & Drake*, 35 F.3d at 1354-55; *see also First Alliance*, 263 B.R. at 112. The statutes and regulations are public health and safety regulations, not economic regulations. To be sure, in some sense *any* state regulation, even regulation directed solely at public safety and welfare, will have some adverse economic consequences, or otherwise could stand in the way of something that a debtor might want to do. But *Baker & Drake* requires (among other things) that the statute "*directly*" conflict with the purposes of the Bankruptcy Code before it can be preempted. Here, at the very least the regulations at issue here no more conflict with the purposes of Bankruptcy Code than the state regulation which prohibited the debtor from leasing its taxicabs in *Baker & Drake*.

2. The Extraordinary Scale of the Preemption Sought by PG&E, and the Fact That Preemption is the Central Purpose of the Proposed Plan, Further Demonstrate That the Proposed Plan is Unconfirmable

PG&E's proposed plan is a deregulation plan, not a reorganization plan. PG&E specifically indicates that it will not seek the approval of any California state or local government office or agency acting in a discretionary capacity, including the Commission. To be sure, upon confirmation of its proposed Plan, the reorganized PG&E (as distinct from the other Reorganized Entities) plans to engage exclusively in the business of retail distribution of gas and electricity, and to be subject to Commission regulation. But as we show immediately below, neither that fact, nor federal regulation of certain Reorganized Entities, even begins to fix the manifest defects of the proposed plan.

The centerpiece of PG&E's proposed plan is the massive and multi-billion dollar transfer of its critical generation and transmission assets to newly created entities *that, according to PG&E, will not be subject to regulation by the State of California*. (As we explain below, it is no answer for PG&E to point to federal regulation as an alleged substitute.) PG&E intends to

make these critical transfers, moreover, without regard to the Commission's statutory obligation and authority to ensure that these transactions comport with state law and will not negatively impact the safety and welfare of the citizens of California. In short, the Plan is designed to use the bankruptcy laws to strip the Commission (and any other state agency) of jurisdiction over three of PG&E's four lines of business. Not only that, the three new entities pursuing those three lines of business, allegedly free from state regulation, will own and operate the very types of utility assets that generate the most intense local public safety and welfare concerns (such as power plants, dams, pipelines, and nuclear reactors) and that in the Commission's view should therefore remain subject to local oversight.

PG&E may contend that it has merely asked the Court to preempt the Commission's regulatory authority to review the restructuring transactions, but that the Commission will regain appropriate regulatory authority once the reorganization is complete. That would be a legally insufficient response, and in any event would not be accurate. By reorganizing in the manner contemplated, PG&E would transfer its "crown jewels" (the generation and transmission operations) to entities that PG&E contends will *never* be regulated by the Commission. PG&E would have *permanently* removed major portions of its business from Commission regulation.

The Commission respectfully submits that Congress could not possibly have intended section 1123(a)(5) to permit the result contemplated by PG&E here: the permanent self-deregulation of the bulk of the operations of a state-created public utility, without an iota of oversight by the Commission and against the sovereign will of the State. Under PG&E's proposed plan, the reorganized entities will operate hydroelectric and nuclear plants in California and transmit electricity and gas through a distribution network criss-crossing California; and the State of California will have absolutely no power to regulate or oversee any of it. This is especially objectionable in light of repeated Congressional indication that the states continue to have a critical role in the regulation of public utilities, even in light of federal regulation of those utilities, as we show immediately below.

3. The Preemptive Orders that PG&E Demands Would Frustrate Congressional Intent to Delegate Regulatory Authority to the States, and Leave Dangerous Gaps in the Regulatory Regime Applicable to the Reorganized PG&E Entities

To be sure, PG&E contends that the reorganized entities will remain subject to certain federal regulation, such as the Federal Power Act (the "FPA") and Natural Gas Act (the "NGA") which are overseen by FERC. *See* Am. Discl. St. at 126. Yet under PG&E's construction, section 1123(a)(5) must logically preempt (or at least be capable of preempting) all "nonbankruptcy" law, not just state law. Presumably, then, PG&E must believe that it could seek to avoid federal regulatory laws as well, should it conclude that those federal laws would make its proposed plan of reorganization more difficult. Some other debtor in some other state may prefer that state's regulation over federal regulation. If section 1123(a)(5) means what PG&E says it does, then such a debtor could use the section to avoid federal regulation. Indeed, because of the special presumptions insulating state law in areas of traditional state concern from federal preemption, it would arguably be slightly *more* rational to seek to displace federal regulation.

In any event, Congress cannot have intended to permit debtors to choose which regulatory regime they prefer and to ignore the other, or for that matter to seek preemption of both regimes. Federal law does not give a state-regulated public utility the right to restructure itself, in violation of state law, by divesting itself of operations potentially subject to federal regulation and placing those operations under actual federal, rather than state, regulation. To the contrary, federal law preserves state regulation of such a restructuring. As we show below, PG&E should not be able to achieve a different result by opportunistically exploiting its bankruptcy to frustrate the policies of highly important and technically complex federal and state regulatory law.

Furthermore, federal regulation is not an adequate substitute for state regulation on many levels, because for example, state regulation provides greater access for local citizens, businesses, and interest groups to participate in the process, and because the Commission's staff and employees has greater local expertise. (Lynch Decl. ¶¶ 56-57.) What is more, the preemptive relief PG&E demands would undermine Congressional intent to delegate

enforcement authority to the states. Courts have repeatedly recognized the important role of state regulation of public utilities, and that federal law was meant to *supplement* and not to supplant state regulation of those utilities. The FPA and NGA were enacted to fill in the gaps not covered by state regulation, not to preempt the state. Generally, federal regulation has primarily if not solely concerned wholesale rates, leaving the remaining bulk of regulation to the states. *See Tracy*, 519 U.S. at 290-292; *Conn. Light & Power Co. v. Federal Power Comm'n*, 324 U.S. 515, 525 (1945) ("Progress of the [FPA] bill through various stages shows constant purpose to protect rather than to supervise authority of the states."); *Panhandle E. Pipe Line Co. v. Pub. Serv. Comm'n*, 332 U.S. 507, 517-518 (1947) (NGA "was drawn with meticulous regard for the continued exercise of state power, not to handicap or dilute it in any way.").

The federal regulatory regime that PG&E suggests might suffice to protect the public specifically depends on state regulation that would vanish under PG&E's plan. Notwithstanding that Congress declined to supplant state regulation of public utilities, PG&E would have this Court do just that.

The absence of state regulation would result in dangerous gaps in the regulatory regime applicable to the reorganized PG&E entities. To take but one example, PG&E is trying to avoid the state environmental review that the Commission would conduct under the California Environmental Quality Act ("CEQA"). Under Section 851 of the Public Utilities Code, PG&E has to obtain state approval to sell, lease, or spin off its utility facilities. An application under Section 851 triggers CEQA review. The massive reorganization contemplated by PG&E triggers CEQA, particularly in connection with the spin-off of PG&E's hydroelectric and nuclear facilities. PG&E owns the largest private system of hydroelectric facilities in the nation, consisting of 250 dams and diversions, 99 reservoirs, 68 powerhouses, and 140,000 acres of associated lands. (Lynch Decl. ¶ 9.) Moreover, the disaggregation of a vast hydroelectric system raises significant environmental issues, many of which were identified in the draft environmental impact report prepared when PG&E tried, prepetition, to divest its hydro assets. (*Id.* ¶ 9 & Ex. A.) Similarly, pressing environmental concerns would be raised by PG&E's

proposed spin-off of its Diablo Canyon nuclear power plant. Under PG&E's Plan, however, there would be no environmental review of the spin-off of either its hydro or nuclear generation facilities.

Even if PG&E's proposed transactions were subject to federal regulation, that regulation is less protective of local residents in many instances. For example, FERC uses a "public interest" test that considers certain economic concerns, but not necessarily environmental concerns. *See* Am. Discl. St. Ex. G at 1-2 (no mention of environmental review under FPA). In addition, FERC review under the National Environmental Policy Act ("NEPA"), if it occurs, would likely result in less environmental protection than Commission review under CEQA. *See City of Carmel-by-the-Sea v. U.S. Dep't of Transp.*, 123 F.3d 1142, 150 (9th Cir. 1997) (NEPA's requirements are procedural whereas CEQA's requirements are both procedural and substantive). And finally, PG&E's proposed spin-off of its utility-retained generation ("URG") into Limited Liability Corporations creates an equally large regulatory gap. These new LLCs are removed entirely from regulation. FERC does not regulate generation. *See, e.g., San Diego Gas & Elec. Co. v. Sellers of Energy & Ancillary Servs.*, 93 FERC ¶ 61,294 (2000).

Finally, the Commission has special authority that allow for diversion of gas supplies to captive core customers in emergencies. *See* Cal. Pub. Util. Code. § 739. Such emergency powers to protect the safety and welfare of California citizens would not be available under FERC regulation. Furthermore, the intrastate gas transmission system is closely integrated with the local gas distribution system, and under FERC regulation, this integration will be seriously impaired, interfering with the Commission's ability to protect the health and safety of captive core customers. California ratepayers have paid for the construction of PG&E's intrastate gas transmission system which was built to serve California gas customers. PG&E has an obligation to serve under Commission regulation. Under FERC regulation, there would be no obligation to serve, and captive core customers would lose most of their current rights and protections.

II.

PG&E'S PROPOSED PLAN IS UNCONFIRMABLE BECAUSE IT DEMANDS RELIEF AGAINST THE STATE OF CALIFORNIA THAT IS BARRED BY THE ELEVENTH AMENDMENT AND RELATED PRINCIPLES OF SOVEREIGN IMMUNITY

The doctrine of sovereign immunity embodied in the Eleventh Amendment forbids a federal court from exercising original jurisdiction over claims brought by private plaintiffs against a state or its agencies. *See Edelman v. Jordan*, 415 U.S. 651, 662-63 (1974). Eleventh Amendment immunity "serves to avoid 'the indignity of subjecting a State to the coercive process of judicial tribunals at the instance of private parties.'" *Seminole Tribe v. Florida*, 517 U.S. 44, 58 (1996) (citation omitted). The Eleventh Amendment absolutely bars an action by a private plaintiff in federal court directly against an unconsenting state (or an unconsenting state agency, such as the Commission) regardless of the relief requested.[13]

PG&E demands sweeping and unprecedented declaratory, injunctive, and monetary relief that the Commission and the State of California cannot enforce, against PG&E, not less than fifteen important state regulatory statutes aimed at promoting the safety and welfare of California citizens. These demands are aimed specifically and purposefully at the

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[13] *See Pennhurst State Sch. & Hosp. v. Halderman*, 465 U.S. 89, 100 (1984); *Alabama v. Pugh*, 438 U.S. 781 (1978) (per curiam); *In re Lazar*, 237 F.3d 967, 975-76 (9th Cir. 2001); Richard H. Fallon et al., *Hart and Wechsler's The Federal Courts and the Federal System* 1073 (4th ed. 1996).

Section 106(a) of the Bankruptcy Code purports to abrogate state sovereign immunity with respect to sections 105 and 362 of the Bankruptcy Code. Section 106(a) is unconstitutional in light of the Supreme Court's decision in *Seminole Tribe* that Congress may not abrogate a state's Eleventh Amendment immunity from suit in federal court pursuant to Congress's powers under Article I of the Constitution. *See Mitchell v. Franchise Tax Bd.*, 209 F.3d 1111, 1119 (9th Cir. 2000) ("Section 106(a) has been viewed by most courts addressing the issue as having been passed pursuant to the Bankruptcy Clause of Article I"), *aff'g* 222 B.R. 877, 881 (9th Cir. BAP 1998) ("§ 106(a) is ineffective to abrogate the State's Eleventh Amendment sovereign immunity") (citation omitted; collecting cases); *accord Sacred Heart Hosp. v. Pa. Dep't of Pub. Welfare*, 133 F.3d 237, 245 (3d Cir. 1998); *Dep't of Transp. & Dev. v. PNL Asset Management Co. LLC (In re Estate of Fernandez)*, 123 F.3d 241, 242 (5th Cir. 1997); *Schlossberg v. Maryland (In re Creative Goldsmiths of Washington, D.C., Inc.)* 119 F.3d 1140, 1147 (4th Cir. 1997).

Commission and the State in their capacities as a sovereign regulator, not as ordinary creditors. Moreover, PG&E's demands for relief seek to bar the Commission and the State from exercising sovereign powers that are absolutely fundamental to the State's regulatory authority over PG&E, a public utility, and consequently to the safety and welfare of the citizens of California. PG&E demands that this Court authorize a fundamental and permanent restructuring of its business as a public utility, without any oversight by the Commission or the State to ensure that the restructuring is consistent with state law and appropriately protects public safety and welfare, as those interests are defined under state law and enforced by the State and its agencies.

PG&E also asks for relief that would excuse it, after completion of the proposed reorganization, from compliance with fundamental features of California regulatory law. In particular, PG&E asks that this Court, in substance, enjoin the Commission and the State from enforcing California law that requires PG&E to purchase electricity sufficient to serve consumers in PG&E's service area. Instead, PG&E wants to use this Court to write a substitute statute placing conditions and limitations without any basis in California law on PG&E's duty, as a regulated utility, to serve. The Eleventh Amendment bars PG&E's effort to enjoin the State of California from enforcing basic California regulatory law.

As we show below, the relief that PG&E seeks in its proposed plan against the Commission and the State of California is barred by the Eleventh Amendment and related principles of sovereign immunity.

A. The Court Should Look to the Substance of the Relief Sought by PG&E in its Plan to Determine Whether the Relief is a "Suit" Against the State for Purposes of the Eleventh Amendment

PG&E chose to seek declaratory and injunctive relief against the Commission and the State of California in a chapter 11 plan, rather than in an adversary proceeding. (As we show below, PG&E also impermissibly seeks the functional equivalent of monetary relief.) Had PG&E attempted to obtain the relief it now seeks in an adversary proceeding, that relief would be barred by the Eleventh Amendment. *See Mitchell v. Franchise Tax Bd.*, 209 F.3d 1111, 1116-17 (9th Cir. 2000). That relief is equally barred if sought by way of a plan. The Eleventh

Amendment prohibition on requests for relief against a State encompasses, but extends beyond, requests contained in formal lawsuits or adversary proceedings against a State as a named party. Rather, the Supreme Court has [broadly] defined a "suit" barred by the Eleventh Amendment as "the prosecution, or pursuit, of some claim, demand, *or request* . . . in a court of justice." *Cohens v. Virginia*, 19 U.S. (6 Wheat) 264, 407 (1821) (emphasis added).

In keeping with the general rule that state sovereignty cannot be abrogated through technical evasions and artful pleading, courts take a practical view of what constitutes the prosecution or pursuit "of some claim, demand, or request" against a State. In making such a determination, courts look to "the essential nature and effect of the proceeding." *Ford Motor Co. v. Dep't of Treasury*, 323 U.S. 459, 464 (1945); *accord In re New York*, 256 U.S. 490, 500 (1921). *Cf. Ulaleo v. Paty*, 902 F.2d 1395, 1399 (9th Cir. 1990) (court should look to "the substance not the form of the relief"). If the "essential nature and effect of the proceeding" is the pursuit "of some claim, demand, or request" against a State, then that proceeding is a "suit" against the State for purposes of the Eleventh Amendment.

In the bankruptcy context, the Ninth Circuit has held that earmarks of a "suit" include the application of coercive process and the attempt to invoke the court's *in personam* jurisdiction over the state. *See Goldberg v. Ellet (In re Ellett)*, 254 F.3d 1135, 1139 (9th Cir. 2001) (citing *Mitchell*, 209 F.3d at 1117). Similarly, the Fourth Circuit has articulated the "test" in terms of both procedural and substantive elements, as follows:

> As to the case's procedural posture, two issues are important: first, the degree of coercion exercised by the federal court in compelling the state to attend: and second, whether the resolution, or the remedy, would require our jurisdiction over the state. The substantive consideration focuses upon whether the action was, as stated by Chief Justice Marshall, "the prosecution of some demand in a Court of justice," as opposed to the orderly disposition of an estate, with the states' role limited to that of any other creditor.

In re NVR, LP, 189 F.3d 442, 452 (4th Cir. 1999) (citing *Cohens*, 19 U.S. at 407 and *Ford Motor*, 323 U.S. at 464).

As we show below, the relief PG&E seeks against the State of California in its bankruptcy plan would require the State to pay huge sums of money that PG&E should fund; is

specifically directed against the State of California as a sovereign regulator; and requires exercise of *in personam* jurisdiction over the State. The "essential nature and effect" of the relief PG&E demands in its plan clearly constitutes the pursuit "of some claim, demand, or request" against the State, and is therefore a "suit" barred under the Eleventh Amendment and related principles of sovereign immunity.

B. The "Essential Nature and Effect" of the Relief Demanded by PG&E Involves the Pursuit of a "Claim, Demand, or Request" Against the State, and Such Relief Is Therefore Barred by the Eleventh Amendment

1. The Relief that PG&E Requests Would Require Payment of Money by the State

The quintessential form of relief barred by the Eleventh Amendment, regardless of whether that relief is sought in an adversary proceeding or in a plan, is relief that requires the payment of money by the state. *See Mitchell*, 209 F.3d at 1116-17.

Here, PG&E demands (among other things) that it be exempted from its statutory obligation to fund the net open position to provide sufficient electric power to serve the public. Under California law, an electric utility operating as a monopoly, such as PG&E, has a fundamental "duty to serve" to provide electricity at all times to every ratepayer within its service area. (*Supra* at 5 & n.2.) If demand for power by ratepayers exceeds a utility's generation capacity, the utility must purchase and pay for that power from wholesale suppliers. To avert a disastrous statewide power shortage, the State authorized DWR to purchase electricity to cover the shortfall on behalf of PG&E, known as the "net open position," when PG&E became unable to meet the needs of the customers in its service territory. The legislation authorizing DWR to procure power to satisfy the net open position provides that "[n]othing in this division shall be construed to reduce or modify any electrical corporation's obligation to serve." Cal. Water Code § 80002. The cost to DWR to purchase this power and to fund the net open position has run into the billions of dollars and is increasing.[14]

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[14] The legislation permits DWR to recover those costs from ratepayers. *See* Assembly Bill ABX1 1, Stats. 2001, Ch. 4, as codified at Division 27 of the California Water Code, Section 80002 *et seq*. The administrative and financial burden on the State of having to procure power for PG&E's customers and to fund those activities are nevertheless substantial. In any event, it makes no difference whether the State may ultimately be able to collect the

The obligation to purchase this power, and to pay for it, are obligations of PG&E and should be borne by PG&E. They flow directly from PG&E's fundamental obligation as a public utility to serve its customers. Nevertheless, DWR paid the bill for the additional power and is still paying the bill for additional power. Even now, as power costs have relaxed to the point where PG&E's revenues are again exceeding costs, PG&E seeks to avoid having to assume the net open position. PG&E seeks relief in its proposed plan that would prevent PG&E from assuming the net open position—and, as a practical matter, would thus require DWR to continue paying—until PG&E's self-created "wish list" of conditions is met.

Not only is PG&E demanding that the Court usurp the sovereign regulatory authority of the State to determine the nature and conditions of PG&E's fundamental state obligation to serve, which is a violation of the Eleventh Amendment on its own, PG&E is effectively trying to stick the State with a bill that PG&E, under California law, should have to pay. To be sure, PG&E does not overtly demand that the State pay PG&E. Such a demand would obviously be barred by the Eleventh Amendment. *See Mitchell*, 209 F.3d at 1116-17. Rather, PG&E demands that the State pay third-party power generators on behalf of PG&E. That is a distinction without a difference, and especially where the focus is on the substance and not the form or technicalities of the relief requested.

PG&E attempts to phrase the relief it seeks in connection with the net open position as an injunction against itself. According to PG&E, the Court should order that the reorganized PG&E "will be prohibited from reassuming the net open position of its electric customers until [certain] conditions are met . . . ." (Am. Discl. St. at 112.) But regardless of how PG&E describes the relief requested—regardless, in other words, of whether PG&E asks the Court to order the State to pay the costs of the net open position, or tries to obscure reality by asking the Court to "prohibit" PG&E from complying with its duty under California law to fund

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payments it has made in connection with the net open position, either from taxpayers, ratepayers, or some other entity. *See Regents of the University of Cal. v. Doe*, 519 U.S. 425, 431 (1997) ("The Eleventh Amendment protects the State from the risk of adverse judgments even though the State may be indemnified by a third party.").

the position—the relief PG&E seeks would require the State to continue paying huge sums of money for PG&E. PG&E's highly artificial formulation of the relief it demands only shows how hard PG&E must struggle in its effort to obscure the utter incompatibility of its proposed plan with the Eleventh Amendment.

2. PG&E Demands Affirmative Relief Specifically Directed Against the State of California As a Sovereign Regulator

Whether or not a request for relief would require the payment of money by the State, a request for relief against a State nonetheless constitutes a "suit" against the State for purposes of the Eleventh Amendment if that request presents "some demand" against the State in any capacity other than as an ordinary creditor. *See NVR*, 189 F.3d at 452 (to determine whether a demand for relief is a "suit" under the Eleventh Amendment, the court should consider whether the demand is "'the prosecution of some demand in a Court of justice,' as opposed to the orderly disposition of an estate, with the states' role limited to that of any other creditor") (quoting *Cohens*, 19 U.S. at 407.

Here, PG&E makes just such "demands" against the Commission and the State of California. In fact, the relief PG&E demands in its plan could not be any more specifically directed against the State and its sovereign regulatory authority. As shown in the accompanying Lynch Declaration, the state statutes, regulations, and regulatory authority that PG&E seeks to displace protect important state sovereignty interests in providing for the safety and welfare of California citizens. (Lynch Decl. ¶¶ 25-55.) PG&E demands that the Court order that the Commission and the State are barred from fulfilling their sovereign missions as public regulators—both here and now during PG&E's bankruptcy and on an ongoing basis after PG&E emerges from chapter 11, should a plan ever be confirmed.

The Commission's position here is fully consistent with cases such as *Texas v. Walker*, 142 F.3d 813 (5th Cir. 1998). There, a debtor obtained a discharge order, and the State of Texas subsequently sued to collect a prepetition debt. The Fifth Circuit held that the Eleventh Amendment did not bar the debtor from asserting the discharge order as a defense to the State's claim. *Walker* carefully explained, however, that this result followed from the bankruptcy

court's limited *in rem* jurisdiction over the bankruptcy estate. *See id.* at 822 (explaining that "the power of the bankruptcy court to enter an order confirming a plan . . . derives not from jurisdiction over the state or other creditors, but rather from jurisdiction over debtors and their estates") (quotations omitted). The Supreme Court has explained the limitations on the bankruptcy court's *in rem* jurisdiction:

> he who invokes the aid of the bankruptcy court by offering a proof of claim and demanding its allowance must abide by the consequences of that procedure. If the claimant is a State, the procedure of proof and allowance is not transmitted into a suit against the State because the court entertains objections to the claim. *The State is seeking something from the debtor. No judgment is sought against the State.* The whole process of proof, allowance, and distribution is, shortly speaking, an adjudication of interests claimed in a res. It is none the less such because the claim is rejected in toto, reduced in part, given a priority inferior to that claimed, or satisfied in some way other than payment in cash.

Gardner v. New Jersey, 329 U.S. 565, 573-74 (1947) (citation omitted, emphasis added); *see Goldberg*, 254 F.3d at 1140-41.

PG&E's demands for relief against the Commission and State here are entirely different. In the challenged provisions of the proposed plan, PG&E is not attempting to obtain a general discharge order, pursuant to this Court's *in rem* jurisdiction, that might then affect some claim for money by the Commission or the State against PG&E. It cannot be said here, as the Supreme Court said in *Gardner*, that "[t]he State is seeking something from the debtor." Nor can it be said here, as the Fourth Circuit said in describing certain permissible consequences of reorganization plans, that "the [State's] role [is] limited to that of any other creditor." *In re NVR*, 189 F.3d at 452. Rather, PG&E is seeking something extraordinary against the State: affirmative relief *directed specifically against the Commission and the State* as sovereigns that goes beyond any reasonable understanding of this Court's *in rem* jurisdiction, and that purports to bar the Commission and the State from exercising their regulatory authority over PG&E. Such a demand for relief against an unconsenting State is barred by the Eleventh Amendment.

3. The Relief that PG&E Requests Would Require the Court to Exercise *In Personam* Jurisdiction Over the State of California

PG&E's demand for relief in its proposed plan is barred by the Eleventh Amendment for a related but additional reason. A request for relief against a State constitutes a

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"suit" against the State for purposes of the Eleventh Amendment if adjudication of that request requires the exercise of personal jurisdiction over the State. *See Goldberg*, 254 F.3d at 1139; *Mitchell*, 209 F.3d at 1117; *NVR*, 189 F.3d at 452. Here, the relief PG&E demands would require the Court to assert personal jurisdiction over the State of California.

As explained above, the relief demanded by PG&E is not like the relief that may be granted in connection with the bankruptcy court's *in rem* jurisdiction over PG&E's estate. PG&E's demands for relief do not involve adjudication of any claim by the Commission or the State *as a creditor* for a share of the property of the estate. Rather, PG&E's demands are specifically directed at the State *as a sovereign* and seek to adjudicate claims that PG&E purports to have against the State. These demands do not involve the disposition of any property of the estate in the sense of who gets what, or the adjustment of debtor-creditor relationships with respect to that property. The demands are not primarily directed to adjudicating rights and interests in property of the estate. For these reasons, the Court's *in rem* jurisdiction over the property of the estate does not confer authority on the Court to order the State to take or not to take certain actions in connection with its sovereign regulatory authority, as PG&E has demanded. In order to bind the State in the way PG&E has demanded, the Court would have to exercise personal jurisdiction over the Commission and the State.

The *NVR* case is instructive here. In that case, the Fourth Circuit held that a motion for relief by contested matter was a "suit" against the State, and thus barred by the Eleventh Amendment, because the relief requested would be little more than an advisory opinion in the absence of personal jurisdiction over the State. *See NVR*, 189 F.3d at 453. As in *NVR*, here "[t]he real value of the judicial pronouncement—what makes it a proper judicial resolution of a 'case or controversy' rather than an advisory opinion—is in the settling of some dispute which affects the behavior of the [State] towards [PG&E]." *Id.* (quoting *Hewitt v. Helms*, 482 U.S. 755, 761 (1987)). Such a "judicial pronouncement" respecting the conduct of the State, the *NVR* court held, is barred by the Eleventh Amendment.

C. Neither the Commission Nor the State Has Waived Its Sovereign Immunity

PG&E has not contended in this Court that the Commission or the State has waived its sovereign immunity. PG&E, however, took the position during its appeal of this Court's decision to dismiss its adversary proceeding against the Commission and its Commissioners that the Commission has waived its sovereign immunity. PG&E is wrong.

On appeal, PG&E contended that the Commission had waived its sovereign immunity because state agencies had filed proofs of claim in the bankruptcy proceeding and because state agencies had "participated" in the chapter 11 case. If PG&E chooses to make those arguments to this Court, they should be rejected for the reasons set forth in the Commission's memorandum on appeal. (Ex. B hereto.)

CONCLUSION

For the foregoing reasons, the Commission respectfully submits that the Court should not approve PG&E's proposed disclosure statement because the statement describes a plan that is unconfirmable on its face.

Dated: January 8, 2002

Respectfully,

GARY M. COHEN
OFFICE OF THE GENERAL COUNSEL,
CALIFORNIA PUBLIC UTILITIES COMMISSION

Gary M. Cohen by

GARY M. COHEN

- and -

ALAN W. KORNBERG
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Attorneys for Defendants/Appellees/Cross-Appellants

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EXHIBIT A

EXHIBIT A

LEGISLATIVE HISTORY APPENDIX

96TH CONGRESS, 2d Session | HOUSE OF REPRESENTATIVES | REPORT No. 96-1195

AN ACT TO CORRECT TECHNICAL ERRORS, CLARIFY AND MAKE MINOR SUBSTANTIVE CHANGES TO PUBLIC LAW 95-598

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[To accompany S. 658]

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These same last-minute changes also resulted in the enactment of a bill that contains incongruent provisions; material that was removed from earlier versions remained as either cross-references or antecedents for provisions changed or inserted. And, material added often was not completely integrated into the total fabric of the bill as enacted.

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periods specified in subsection (c) of this section and after notice and a hearing, the court may for cause reduce or increase the 120-day period or the 180-day period referred to in this section.

* * * * * * *

§ 1123. Contents of plan

(a)[A] *Notwithstanding any otherwise applicable nonbankruptcy law, a* plan shall—

(1) designate, subject to section 1122 of this title, classes of claims, other than claims of a kind specified in section 507(a)(1), 507(a)(2), or 507(a)(6) of this title, and classes of interests;

(2) specify any class of claims or interests that is not impaired under the plan;

(3) [shall] specify the treatment of any class of claims or interests that is impaired under the plan;

(4) provide the same treatment for each claim or interest of a particular class, unless the holder of a particular claim or interest agrees to a less favorable treatment of such particular claim or interest;

(5) provide adequate means for the plan's [execution] *implementation*, such as—

(A) retention by the debtor of all or any part of the property of the estate;

(B) transfer of all or any part of the property of the estate to one or more entities, whether organized before or after the confirmation of such plan;

(C) merger or consolidation of the debtor with one or more persons;

(D) sale of all or any part of the property of the estate, either subject to or free of any lien, or the distribution of all or any part of the property of the estate among those having an interest in such property of the estate;

(E) satisfaction or modification of any lien;

(F) cancellation or modification of any indenture or similar instrument;

(G) curing or waiving *of* any default;

(H) extension of a maturity date or a change in an interest rate or other term of outstanding securities;

(I) amendment of the debtor's charter; or

(J) issuance of securities of the debtor, or of any entity referred to in subparagraph (B) or (C) of this paragraph, for cash, for property, for existing securities, or in exchange for claims or interests, or for any other appropriate purpose;

(6) provide for the inclusion in the charter of the debtor, if the debtor is a corporation, or of any corporation refered to in paragraph (5)(B) or (5)(C) of this subsection, of a provision prohibiting the issuance of nonvoting [equity securities] *common stock* and providing, as to the several classes of securities possessing voting power, an appropriate distribution of such power among such classes, including, in the case of any class of equity securities having a preference over another class of equity securi-

ties with respect to dividends, adequate provisions for the election of directors representing such preferred class in the event of default in the payment of such dividends; and

(7) contain only provisions that are consistent with the interests of creditors and equity security holders and with public policy with respect to the manner of selection of any officer, director, or trustee under the plan and any successor to such officer, director, or trustee.

(b) Subject to subsection (a) of this section, a plan may—

(1) impair or leave unimpaired any class of claims, secured or unsecured, or of interests;

(2) subject to section 365 of this title, provide for the assumption [or rejection], *rejection, or assignment* of any executory contract or unexpired lease of the debtor not previously rejected under *such* section [365 of this title];

(3) provide for—

(A) the settlement or adjustment of any claim or interest belonging to the debtor or to the estate; or

(B) the retention and enforcement by the debtor, by the trustee, or by a representative of the estate appointed for such purpose, of any such claim or interest;

(4) provide for the sale of all or substantially all of the property of the estate, and the distribution of the proceeds of such sale among holders of claims or interests; and

(5) include any other appropriate provision not inconsistent with the applicable provisions of this title.

(c) In a case concerning an individual, a plan proposed by an entity other than the debtor may not provide for the use, sale, or lease of property exempted under section 522 of this title, unless the debtor consents to such use, sale, or lease.

§ 1124. Impairment of claims or interests

Except as provided in section 1123(a)(4) of this title, a class of claims or interests is impaired under a plan unless, with respect to each claim or interest in such class, the plan—

(1) leaves unaltered the legal, equitable, and contractual rights to which such claim or interest entitles the holder of such claim or interest;

(2) notwithstanding any contractual provision or applicable law that entitles the holder of such claim or interest to demand or receive accelerated payment of such claim or interest after the occurrence of a default—

(A) cures any such default [,] *that occurred before or after the commencement of the case under this title*, other than a default of a kind specified in section 365(b)(2) of this title [, that occurred before or after the commencement of the case under this title];

(B) reinstates the maturity of such claim or interest as such maturity existed before such default;

(C) compensates the holder of such claim or interest for any damages incurred as a result of any reasonable reliance by such holder on such contractual provision or such applicable law; and

TAB 2

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Section 100(a). This amendment makes several stylistic changes.

Subsection (b). This amendment makes it clear that the character of cause justifying the court's converting a case under chapter 11 to a case under chapter 7 includes a denial of additional time for filing a plan where such has been requested; and makes it clear that time limitations are in a correlative not conjunctive relationship with each other.

Section 101(a). This amendment makes a stylistic change.

Subsection (b). This amendment makes it clear that changes in the times for filing a plan under section 1121(c) can be made by the court only if the request for such a change is made within the time specified for each circumstance.

Section 102(a). This amendment makes it clear that the rules governing what is to be contained in the reorganization plan are those specified in this section; deletes a redundant word; and makes several stylistic changes.

Subsection (b). This amendment makes a conforming change: and deletes a redundant cross-reference.

Section 103. This amendment makes a stylistic change; and makes it clear that time period limitations are in a correlative not conjunctive relationship with each other.

Section 104(a). This amendment makes it clear that the requirement of providing adequate information about the plan does not include information about other plans which may be proposed; and makes several stylistic changes.

Subsection (b). This amendment makes it clear that the disclosure statement which is not subject to otherwise applicable nonbankruptcy law is the statement required by this section; and that the approval of such a statement is not subject to review other than through the process of approval required hereunder.

Subsection (c). This amendment makes it clear that the solicitation that is protected by the safe harbor provision is that of acceptances and rejections of the plan.

Section 105(a). This amendment makes a stylistic change.

Subsection (b). This amendment corrects an error in punctuation.

Subsection (c). This amendment corrects several errors in spelling.

Subsection (d). This amendment makes a stylistic change.

Section 106(a). This amendment makes several stylistic changes.

Subsection (b). This amendment makes a stylistic change.

Section 107(a). This amendment makes it clear that a plan may not be confirmed unless it and its proponent comply with, inter alia, all applicable provisions of title 11; makes several stylistic changes; and corrects a spelling and a punctuation error.

Subsection (b). This amendment deletes an erroneous cross-reference; makes several stylistic changes; makes it clear in the application of the absolute priority rule regarding the holders of unsecured claims that junior claim or interest holders may not receive or retain property under the plan unless those senior to them have been appropriately dealt with; and makes it clear that in determining the value of property interest holders must receive, such value may be based upon one or the other of the standards provided for in section 1129(b)(2)(C)(i).

TAB 3

Bankruptcy Law Reports

NUMBER 30 NOVEMBER 20, 1980 PART II

TECHNICAL AMENDMENTS TO BANKRUPTCY REFORM ACT OF 1978

Text of House Report No. 96-1195, Parts 1 and 2, as reported by the House Committee on the Judiciary; and Text of S. 658 as passed by the House with comments.

Extra copies are available from Commerce Clearing House, Inc., 4025 W. Peterson Ave., Chicago, Illinois 60646. Price: 1-4 Copies, $2.30 each; 5-9 Copies, $2.20 each; 10-24 Copies, $2.00 each; 25-49 Copies, $1.80 each.

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CORRECTING TECHNICAL ERRORS AND MAKING MINOR SUBSTANTIVE CHANGES TO PUBLIC LAW 95-598

Mr. EDWARDS of California. Mr. Speaker, I move to suspend the rules and pass the Senate bill (S. 658), to correct technical errors, clarify and make minor substantive changes to Public Law 95-598, as amended.

The Clerk read as follows:

S. 658

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

TITLE I—AMENDMENTS TO TITLE 11 OF THE UNITED STATES CODE

SECTION 1. (a) Section 101(2)(D) of title 11 of the United States Code is amended by striking out "or all" immediately after "business".

(b) Section 101(8)(E) of title 11 of the United States Code is amended by striking out the colon at the end thereof and inserting a semicolon in lieu thereof.

(c) Section 101(9)(B) of title 11 of the United States Code is amended by inserting "348(d), 502(e)(2)," immediately after "section".

(d) Section 101(14) of title 11 of the United States Code is amended by inserting "and" immediately after "trust,".

(e) Section 101(24) of title 11 of the United States Code is amended by striking out "stock broker" and inserting "stockbroker" in lieu thereof.

(f) Section 101(26)(B) of title 11 of the United States Code is amended—

(1) in clause (i), by striking out "the kind specified in subparagraph (A)(i) of this paragraph; and" and inserting "a kind specified in subparagraph (A)(i) of this paragraph; or" in lieu thereof; and

(2) in clause (ii) by striking out "separate" each place it appears and inserting "nonpartnership" in lieu thereof and by striking out "the kind specified in subparagraph (A)(ii)" and inserting "a kind specified in subparagraph (A)(i) or (A)(ii)" in lieu thereof.

(g) Section 101 of title 11 of the United States Code is amended—

(1) by redesignating paragraphs (25), (26), (27), (28), (29), and (40) as paragraphs (26), (27), (28), (40), (41), and (42) respectively; and

(2) by adding immediately after paragraph (24) the following new paragraph:

"(25) 'securities clearing agency' means person that is registered as a clearing agency under section 17A of the Securities Exchange Act of 1934 (15 U.S.C. 78q-1), or whose business is confined to the performance of functions of a clearing agency with respect to 'exempted securities', as defined in section 3(12) of such Act (15 U.S.C. 78c(12)) for the purposes of such section 17A;".

(h) Section 101(26)(A)(xii) of title 11 of the United States Code, as so redesignated, is amended by striking out "is the subject of a registration statement" and inserting "is required to be the subject of a registration statement" in lieu thereof.

(i) Section 101(26)(B)(iii) of title 11 of the United States Code, as so redesignated, is amended by striking out "commodity" the second place it appears.

(j) Section 101(26)(B)(vi) of title 11 of the United States Code, as so redesignated, is amended—

(1) by striking out "certificate specified in clause (xii) of subparagraph (A)" and inserting "certificate of a kind specified in subparagraph (A)(xii)" in lieu thereof; and

(2) by striking out "the subject of such a registration statement" and inserting "required to be the subject of a registration statement" in lieu thereof.

(k) Section 101 of title 11 of the United States Code is amended by inserting immediately after paragraph (38), as so redesignated, the following new paragraph:

"(39) 'State' includes the District of Columbia and Puerto Rico, except for the purpose of who may be a debtor under chapter 9 of this title;".

(l) Section 101(41) of title 11 of the United States Code, as so redesignated, is amended to read as follows:

"(41) 'stockbroker' means person—

"(A) with respect to which there is a customer, as defined in section 741 of this title; and

"(B) that is engaged in the business of effecting transactions in securities—

"(i) for the account of others; or

"(ii) with members of the general public, from or for such person's own account;".

(m) Section 101(42) of title 11 of the United States Code, as so redesignated, is amended by striking out the period and inserting "; and" in lieu thereof.

(n) Section 101 of title 11 of the United States Code is amended by adding at the end thereof the following new paragraph:

"(43) 'United States', when used in a geographical sense, includes all locations where the judicial jurisdiction of the United States extends, including territories and possessions of the United States.".

SEC. 2. Section 102(8) of title 11 of the United States Code is amended by striking out "continued" and inserting "contained" in lieu thereof.

SEC. 3. (a) Section 103(c) of title 11 of the United States Code is amended by striking out "stockholder" and inserting "stockbroker" in lieu thereof.

(b) Section 103(d) of title 11 of the United States Code is amended by striking out "except with respect to section 746(c) which applies to margin payments made by

United States Code is amended by striking out "estate, and" and inserting "estate and of the" in lieu thereof.

Sec. 96. Section 1106(b) of title 11 of the United States Code is amended by inserting ", except to the extent that the court orders otherwise," immediately before "any other".

Sec. 97. Section 1107(a) of title 11 of the United States Code is amended by inserting "serving in a case" immediately after "or a trustee".

Sec. 98. Section 1108 of title 11 of the United States Code is amended by inserting ", on request of a party in interest and after notice and a hearing," immediately after "court".

Sec. 99. Section 1111(b) of title 11 of the United States Code is amended to read as follows:

"(b)(1) Except where property of the estate that secures a claim is sold subject to section 363(k) of this title, abandoned under section 554 of this title, or surrendered to the holders of such claims, or is to be sold, abandoned, or surrendered under the plan—

"(A) a claim secured by such property shall be allowed or disallowed under section 502 of this title the same as if the holder of such claim had recourse against the debtor on account of such claim, whether or not such holder had such recourse, unless the class of which such claim is a part elects, by at least two-thirds in amount and more than one-half in number of allowed claims of such class, to be governed by subparagraph (B) of this paragraph; and

"(B) unless the aggregate value of the interests in such property of the holders of such claims is inconsequential, the class may elect, as provided under subparagraph (A) of this paragraph, that such claims of such class, whether or not the holders of such claims had recourse against the debtor and notwithstanding section 506(a) of this title, are secured claims to the full extent that such claims are allowed.

"(2) The provisions of paragraph (1)(A) of this subsection are limited to the purposes of this chapter and such paragraph does not in any other way alter, affect, or create any right or liability of any other entity.".

Sec. 100. (a) Section 1112(a) of title 11 of the United States Code is amended—

(1) in paragraph (2), by striking out "is an involuntary case originally commenced under this chapter" and inserting "originally was commenced as an involuntary case under this chapter" in lieu thereof; and

(2) in paragraph (3), by striking out "on other than" and inserting "other than on" in lieu thereof.

(b) Section 1112(b) of title 11 of the United States Code is amended—

(1) in paragraph (5), by inserting "a request made for" immediately before "additional"; and

(2) in paragraph (8), by striking out "and" inserting "or" in lieu thereof.

Sec. 101. (a) Section 1121(c)(3) of title 11 of the United States Code is amended by striking out "the claims or interests of which are" and inserting "of claims or interests that is" in lieu thereof.

(b) Section 1121(d) of title 11 of the United States Code is amended by inserting "made within the respective periods specified in subsection (c) of this section" immediately after "interest".

Sec. 102. (a) Section 1123(a) of title 11 of the United States Code is amended—

(1) by striking out "A" and inserting "Notwithstanding any otherwise applicable nonbankruptcy law, a" in lieu thereof;

(2) in paragraph (1), by inserting a comma immediately after "classes of claims" and immediately after "507(a)(6) of this title";

(3) in paragraph (3), by striking out "shall";

(4) in paragraph (5), by striking out "execution" and inserting "implementation" in lieu thereof;

(5) in paragraph (5)(G), by inserting "of" immediately after "waiving"; and

(6) in paragraph (8), by striking out "equity securities" the first place it appears and inserting "common stock" in lieu thereof.

(b) Section 1123(b)(2) of title 11 of the United States Code is amended by striking out "or rejection" and inserting ", rejection, or assignment" in lieu thereof and by striking out "under section 365 of this title" and inserting "under such section" in lieu thereof.

Sec. 103. Section 1124 of title 11 of the United States Code is amended—

(1) by amending paragraph (2)(A) to read as follows:

"(A) cures any such default that occurred before or after the commencement of the case under this title, other than a default of a kind specified in section 365(b)(2) of this title;"; and

(2) in paragraph (3)(B)(i), by striking out "and" and inserting "or" in lieu thereof.

Sec. 104. (a) Section 1125(a) of title 11 of the United States Code is amended—

(1) in paragraph (1), by inserting ", but need not include such information about any other possible or proposed plan" immediately after "plan";

(2) in paragraph (2)(B), by inserting "the" immediately after "with"; and

(3) in paragraph (2)(C), by inserting "of" immediately after "holders".

(b) Section 1125(d) of title 11 of the United States Code is amended—

(1) by inserting "required under subsection (b) of this section" immediately after "statement" the first place it appears; and

(2) by inserting ", or otherwise seek review of," immediately after "appeal from".

(c) Section 1125(e) of title 11 of the

TAB 4

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These same last-minute changes also resulted in the enactment of a bill that contains incongruent provisions; material that was removed from earlier versions remained as either cross-references or antecedents for provisions changed or inserted. And, material added often was not completely integrated into the total fabric of the bill as enacted.

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Such matters consitute the vast majority of the subject of the Technical Amendments Act. In addition, however, there are several items of a substantive nature which are included because: (1) it was intended that the particular subject was to be dealt with at the earliest possible time after the enactment of the Bankruptcy Refore Act in connection with whatever technical amendments would be considered; (2) further conforming changes were found to be necessary to complete the legislative work intended by the Bankruptcy Reform Act; (3) the treatment of a subject in the Bankruptcy Reform Act was found to be incomplete; or (4) there was overlooked some minor yet relevant matter. In each case the change proposed is consistent with policies adopted by Congress in its enactment of the Bankruptcy Reform Act.

Even with these substantive matters included and noting that they are consistent with the Bankruptcy Reform Act, nevertheless it is important to repeat that the Act as amended by this bill continues to represent a finely tuned and balanced treatment of the respective interests of debtors and creditors. Every effort has been made to abstain from reacting legislatively at every call for change and to maintain existing policy intact. At this time, there are known areas of bankruptcy activity which give the Committee concern and which the Committee intends to monitor closely. However, it is also premature to change a statute that has been in effect for such a short period of time where it is not really known to what extent these concerns are other than transitory.

Bankruptcy Judge's Retirement

H.R. 6200, as reported by the Committee during the 95th Congress, contained provisions to reorganize bankruptcy courts and include them within the category of United States courts subject to the standards of Article II of the Constitution. S. 2266, the bill passed by the Senate during the 95th Congress, which eventually became Public Law 95-598 (the Bankruptcy Reform Act of 1978), did not contain such provisions. Numbered among the provisions contained in H.R. 6200 were those which would have provided for retirement of bankruptcy judges. When this general subject was resolved between the House and the Senate, the matter of bankruptcy judge's retirement was eliminated with the understanding that at the earliest possible time it would be dealt with.

There are two classes of United States judges: life tenure; and fixed term tenure. Notwithstanding, all United States judges, for retirement purposes, participate in what loosely may be called "judicial retirement." The essential characteristics of this retirement system are: (1) it is noncontributory; (2) eligibility for retirement at 100 percent of the salary a judge received at the time of retirement is based upon the reaching of seventy years of age with 10 or more years of service or sixty-five years of age with 15 or more years of service; and, in the case of fixed term judges, (3) provision for 100 percent or less benefits in the event of failure of reappointment.

Bankruptcy judges presently are participants in the civil service retirement system. The essential characteristics of this system are: (1) it is contributory; (2) benefits accrue at the rate of approximately

TAB 5

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2 percent per year for each year of service; (3) benefits are available only after the participant has reached the age of sixty-two years; and (4) there is an 80 percent cap on the amount of benefits receivable. The civil service retirement system does not provide an equitable basis for retirement for bankruptcy judges vis-a-vis other United States judges.

The civil service system is predicated upon an individual's coming to work for the Federal government at an early age, usually in a person's early twenties. The average age of bankruptcy judges ascending to the bench is forty-five.

The overwhelming opinion on this subject, including that of the Judicial Conference of the United States, is that bankruptcy judges should participate in the judicial retirement system. Differences of opinion exist regarding the extent to which credit for service should be given for service as a bankruptcy judge during the transition period (that time between the enactment of the Bankruptcy Reform Act and the taking effect of the new bankruptcy court created under that Act) and for service as a referee in bankruptcy prior to the enactment of the Bankruptcy Reform Act. This bill strikes a compromise between the position of giving such judges 100 percent credit for all such prior service and only allowing the participation in the judicial retirement system based upon service on the new court beginning April 1, 1984.

A complicated formula with a number of conditions and limitations has been created. The objective of this scheme is to not only provide an equitable basis for bankruptcy judges' retirement, but also to act as an incentive to keep on the bench the experience and ability of bankruptcy judges presently sitting. It is also important to understand that the system by which bankruptcy judges will be chosen has been changed by the Bankruptcy Reform Act. This change will undoubtedly have an adverse effect upon the ability of bankruptcy courts to retain some of the most knowledgeable and experienced of the bankruptcy judges.

Under the law that was repealed by the Bankruptcy Reform Act, bankruptcy judges were selected by the judges of the United States district court for the district wherein the bankruptcy judge would serve. Under the Bankruptcy Reform Act, bankruptcy judges will be nominated by the President. This change should not, in the best of all possible worlds, have the effect of displacing such experienced and knowledgeable judges. However, as this can be the case, enhancing bankruptcy judges' retirement will be an incentive for judges to seek presidential appointment and remain on the bench for a longer period of time.

The numerator for computing the amount of salary payable to a judge who is not reappointed at the end of his term is changed from sixteen years to fourteen years to conform to the term of office of a bankruptcy judge appointed under the Bankruptcy Reform Act.

Incumbent bankruptcy judges are given full credit for all service prior to April 1, 1984, for the purpose of determining eligibility for benefits, but the rate of accrual of salary payable to a bankruptcy judge upon relinquishing office by resignation or upon failure of reappointment is substantially less for service prior to November 6, 1978, the date of enactment of the Bankruptcy Reform Act.

The formula for computing the rate of accrual of salary payable to a bankruptcy judge upon relinquishment of office, if he meets the age and length of service requirements for benefits, is 1/28 for service as a

bankruptcy judge prior to November 6, 1978 and 1/14 for service as a bankruptcy judge on and after that date. The difference in the rate of accrual of benefits for service as a bankruptcy judge prior to November 6, 1978 and for such service thereafter is adopted in recognition of the fact that the duties and responsibilities of the office of bankruptcy judge and the stature and jurisdiction of the bankruptcy court were greatly enhanced by the Bankruptcy Reform Act of 1978. The 1/14 formula will apply to all service as a bankruptcy judge prior to April 1, 1984 by a bankruptcy judge who is reappointed after that date if such a judge continues in service as a bankruptcy judge for a period of five years after the date of his reappointment or until he attains the age of seventy years.

Upon enactment of this bill an incumbent bankruptcy judge who is or may become eligible for benefits under section 373 of title 28 of the United States Code may elect coverage under that section, without regard to the date of such eligibility. To prevent so-called double-dipping, the election of benefits under section 373 voids the annuity rights of a bankruptcy judge under any other Federal employee pension plan.

An incumbent bankruptcy judge who has elected the benefits of section 373 of title 28 of the United States Code, but who has not attained the age of sixty-five years prior to April 1, 1984, forfeits all rights to future payments under that section unless such judge has filed with the President, the President of the Senate, and the Director of the Administrative Office of the United States Courts before April 1, 1984, a written notice agreeing to accept appointment as a bankruptcy judge after such date and, if offered such appointment, accepts such appointment.

The right of incumbent bankruptcy judges who meet the length of service requirements of section 373 of title 28 of the United States Code, to resign and receive payments under that section prior to April 1, 1984, is restricted to two categories of judges—(1) those judges who have attained the age of seventy years, and (2) any judge who has attained the age of sixty-five years and provides the Director of the Administrative Office of the United States Courts a certificate of disability signed by the chief judge of the circuit. Otherwise, incumbent bankruptcy judges are precluded from receiving benefits under the section prior to April 1, 1984.

Upon enactment of this bill, incumbent bankruptcy judges will become judges of the United States, which would ordinarily make them ineligible for continued coverage under the Civil Service Retirement system. However, the right of a bankruptcy judge continued in office by section 404(b) of the Bankruptcy Reform Act of 1978 to retain coverage under the Civil Service Retirement system is preserved until such time as he elects coverage under section 373 of title 28 of the United States Code.

The term "bankruptcy judge" is defined to include a referee in bankruptcy to make it clear that all service as a referee in bankruptcy is includible for purposes of this section.

A definition of "reappointment" to include appointment to the new bankruptcy court which comes into existence on April 1, 1984, is included to make clear the fact that incumbent bankruptcy judges, whose terms expire at the end of the transition period, who are not

appointed to the new court by the President immediately following the transition period are deemed to have failed of reappointment for the purposes of this section.

The word "retires" and "retirement" are used in this section in a broad generic sense and are intended to include voluntary resignation or involuntary resignation because of failure of reappointment.

An incumbent bankruptcy judge who, after continuing to serve throughout the transition period, fails of reappointment, and who at the time of relinquishing office has fourteen or more years of service as a bankruptcy judge, is eligible to receive benefits under this section before attaining the age of sixty-five years. However, the salary payable to such judge shall be reduced by one-sixth of one percent for each full month such judge is under sixty-five years of age at the time he relinquishes office.

Municipal Financing

In structuring the Bankruptcy Reform Act, one of the objectives, simplification, was achieved by consolidating into one chapter (11) a number of the previously separate provisions dealing with reorganizations. Now, there are only four distinct types of proceedings under title 11: liquidation, under chapter 7; adjustment of debts of a municipality, under chapter 9; reorganization, under chapter 11; and adjustment of debts of individuals with regular income, under chapter 13. This organizational arrangement, however, required that the general provisions contained in chapters 1, 3, and 5 either be made applicable or inapplicable, as was appropriate.

One such provision, contained in section 552, deals with the post-petition effect of a security interest. In arriving at the treatment of this subject as it did, the Bankruptcy Reform Act expressed the general policy that upon the filing of a petition in bankruptcy, except for proceeds, there would be no post-petition effect of a security interest. The central frame of reference for this decision was commercial transactions and the recognition and acceptance of after-acquired property clauses by the Uniform Commercial Code (adopted universally by the States, with the exception of Louisiana). This provision was made applicable to a proceeding under chapter 9.

After the enactment of the Bankruptcy Reform Act, attention was called to the fact of this applicability and that as a result certain municipal bondholders' interests in specific funds might be jeopardized in the event of the filing of a petition by the municipality under chapter 9. Revenue bonds issued by a municipality are in effect longer term secured obligations, the security for which is a specific fund(s). The bond indenture is the security agreement setting forth the security interest which, invariably, contains a provision for the repayment of the bond obligation from a specific fund(s) as such fund(s) is generated from time to time. Therefore, with section 552 applicable in a chapter 9 proceeding, upon the filing of a petition by a municipality, bondholders' rights to the specific fund(s) would be impaired.

S. 658 as enacted by the Senate contains a provision, a new section 928, designed to overcome the potential limiting effect section 552 would have on municipal revenue bonds in the event of the filing of

a petition by a municipal issuer of such securities. Because this Senate-proposed section 928 deals only with traditional revenue bonds and not other forms of municipally issued securities secured by specified funds, concern was raised that the Senate's section 928 of S. 658 was not adequate. In seeking to eliminate section 552's limiting effect upon all municipal securities secured by specified funds, whether of the traditional revenue bond type, or some other type, the Committee sought a way to do this without placing itself in the position of making any express representation to States and municipalities regarding the character or quality of their securities under non-bankruptcy law. The Committee believes that it was not the intent of Congress in the enactment of the Bankruptcy Reform Act of 1978 to make any such representations. Therefore, it has chosen to deal with the limiting effect of section 552 by deleting the reference to it from section 901, removing from application in a chapter 9 proceeding the operation of that section.

Further, the Committee believes that it was not the intent of Congress in the enactment of 547(e)(3) to penalize holders of municipal securities which are secured by future receipts of the issuer. The deletion from section 901 of the reference to section 547(e)(3) would avoid allowing such payments to be classified as voidable preferences under section 547.

Stockbroker/Commodity Broker Liquidations

Prior to the enactment of the Bankruptcy Reform Act special provisions existed in the bankruptcy laws for liquidations of stockbrokers. Much of this prior law served as the basis for what has become subchapter III of chapter 7 in the new Bankruptcy Code. The new subchapter IV, dealing with commodity broker liquidations, is new and not based upon any prior treatment under the repealed Bankruptcy Act. These subchapters were intended to provide comparable treatment for stockbroker and commodity broker liquidations. Moreover, it also was intended that in the event of a bankruptcy involving such an entity, the operations of the respective securities and commodities markets would be affected only minimally, i.e., that the financial failure of any one such entity would not have such an affect upon an entire marketplace so as to pose the potential for a massive disruption of the entire industry. However, quite soon after the enactment of the Bankruptcy Reform Act it was brought to the Committee's attention that the provisions in subchapters III and IV fell short of their intended mark. In short, the integrity of the securities and commodities markets was not adequately protected; and there was not comparability between the provisions of subchapters III and IV.

There are a number of provisions in the bill which pertain to stockbrokers, securities clearing agencies, commodity brokers and forward contract merchants. These are intended to clarify the application to these entities of certain provisions contained in the Bankruptcy Reform Act. The Bankruptcy Reform Act provides a number of protections to commodity brokers and commodity clearing organizations, and several amendments have been made to clarify that these

same protections are intended to apply to stockbrokers and securities clearing agencies. The overall purpose of these provisions is to preserve the financial integrity of the nation's commodity and securities markets.

Provision was also necessary to clarify that the automatic stay provision does not affect the setoff of mutual debts and claims which relate to commodity contracts, forward contracts, leverage transactions or securities contracts; nor does it prevent setoffs against customer property held by a commodity broker, forward contract merchant, stockbroker or securities clearing agency for claims which are margin or settlement payments.

Related amendments also preserve the contractual rights of stockbrokers, securities clearing agencies, commodity brokers and forward contract merchants to liquidate a debtor's account, notwithstanding the automatic stay of Section 362, or any other provision of Federal or State law or court order, unless the court order is authorized under the Securities Investor Protection Act of 1970 (15 U.S.C. 78aaa et seq.) or is required because of a threat to the national security.

In Subchapter III, Section 749 has been amended to give the Securities and Exchange Commission the power to approve specified transfers so approved may not be avoided by the trustee. This authority corresponds to the authority given to the Commodity Futures Trading Commission in Section 764(b).

In Subchapter IV, the definition of "customer" has been amended to delete the reference to debtor and substitute in its place a broader reference. Under the previous definition, only an entity which was a debtor could have a customer. Such a result would have defeated the broad protections intended to be provided by the Act. Other clarifying amendments have been made to several of the definitions to be sure that if trading in commodity options is approved by the CFTC, such trading will be included within the scope of Subchapter IV provisions.

It is also made clear that the trustee may not avoid as a preference or fraudulent transfer, a margin payment, deposit or settlement payment made by or to a commodity broker, forward contract merchant, stockbroker or securities clearing agency, unless the payment is both made and received with intent to defraud.

Finally, Subchapter IV of chapter 7 has been amended to clarify that the proprietary accounts of commodity brokers are not entitled to share in any distribution from the customer property estate until such time as all other customer net equity claims have been paid in full.

Tax Provisions

The Bankruptcy Reform Act's repeal of the former Bankruptcy Act removed from applicability the special provisions for treatment of tax consequences of transactions arising in a bankruptcy context. This was done with the view that soon after the enactment of the Bankruptcy Reform Act there would be considered bankruptcy tax legislation. However, to initiate the process whereby such tax legislation would be considered, there was included in section 346 a number of provisions designed to identify a basis upon which tax consequences could be determined.

With the consideration of the Technical Amendments Act, this tax legislation has not yet been fully considered and the provisions of section 346, therefore, exist in a vacuum.

These section 346 provisions are being removed with the intention that (1) there should be a uniform treatment of tax consequences in bankruptcy under both State and federal law, (2) federal tax legislation should be considered at the earliest possible time, and (3) until such legislation is enacted it is most desirable that tax consequences of bankruptcy should be dealt with as they were under the former Bankruptcy Act.

SECTION-BY-SECTION ANALYSIS

TITLE I

Section 1(a). This amendment deletes a redundancy.

Subsection (b). This amendment corrects a typographical error.

Subsection(c). This amendment corrects the cross-references identifying the types of claims to be treated as pre-petition claims to include certain preconversion and co-debtor claims.

Subsection(d). This amendment corrects an omission by providing the connective to assure that "entity" is defined to include all of the types specified.

Subsection (e). This amendment corrects a typographical error.

Subsection (f). This amendment to the definition of "insolvent" with reference to a partnership clarifies that it is the general partner nonpartnership property that is the subject of valuation eliminating the ambiguity presented by the use of the term "separate" which allowed for the reference to noncommunity property in a community property stae; substitutes the indefinite article with reference to the types of property excluded from the valuation; and adds a cross-reference to include all property appropriately to be excluded from the valuation.

Subsection (g). This amendment redesignates paragraphs (35), (36), (37), (38), (39), and (40) to allow for the addition of two new definitions; and adds as one of the new paragraphs a definition for "securities clearing agency" to facilitate the treatment of stockbroker bankruptcies under subchapter III of chapter 7.

Subsection (h). This amendment clarifies that the term "security" is applicable to the designated contract or interest if such is required to be the subject of a Securities Act registration statement whether or not it is so subject.

Subsection (i). This amendment corrects the name of a type of contract excluded from the definition of "security".

Subsection (j). This amendment makes a stylistic change in the cross-reference; and clarifies that the contract or certificate excluded from the definition of "security" is not required to be the subject of a Securities Act registration statement whether or not it is so subject.

Subsection (k). This amendment adds a new paragraph which provides a definition for "State" primarily to assure that residents and domiciliaries of Puerto Rico can become debtors under title 11.

Subsection (l). This amendment makes a stylistic change.

Subsection (m). This amendment makes a change in punctuation to allow an additional paragraph to be added.

TAB 6

Calendar No. 102

98TH CONGRESS, 1st Session | SENATE | REPORT No. 98-65

OMNIBUS BANKRUPTCY IMPROVEMENTS ACT OF 1983

REPORT

OF THE

COMMITTEE ON THE JUDICIARY UNITED STATES SENATE

[To accompany S. 445]

[Together with Additional Views]

Ordered to be printed

U.S. GOVERNMENT PRINTING OFFICE
19-565 O WASHINGTON : 1983

Calendar No. 102

98TH CONGRESS, 1st Session | SENATE | REPORT No. 98-65

OMNIBUS BANKRUPTCY IMPROVEMENTS ACT OF 1983

APRIL 26, 1983—Ordered to be printed

Mr. THURMOND, from the Committee on the Judiciary, submitted the following

REPORT

[To accompany S. 445]

The Committee on the Judiciary, which considered the bill (S. 445) to make certain substantive changes to Public Law 95-598, the Bankruptcy Reform Act of 1978, having considered the same, reports favorably thereon as amended and recommends that the bill as amended do pass.

I. PURPOSE OF THE BILL

The purpose of the bill is to make certain substantive changes in Public Law 95-598, the Bankruptcy Reform Act of 1978.

II. INTRODUCTION AND HISTORY OF THE BILL

On July 12, 1978, the Committee on the Judiciary reported S 2226, the Senate version of the Bankruptcy Reform Act of 1978. On September 20, 1978, H.R. 8200, with further amendments, was passed again by the House. On October 5, 1978, the Senate repassed H.R. 8200, with additional amendments. Finally, on October 6, 1978, the House accepted the final Senate changes and cleared the bill for signature by the President. On November 6, 1978, President Carter signed the bill and it became Public Law 95-598. On October 1, 1979, Public Law 95-598, styled the Bankruptcy Reform Act of 1978, went into effect.

In the 97th Congress, the Subcommittee on Courts, chaired by Senator Dole, held general oversight hearings on the Bankruptcy Reform Act of 1978 on April 3 and 6, 1981. As a result of those hearings, numerous amendments, largely technical in nature, were proposed which were passed by the Senate as S. 863, the Bankruptcy Amendments Act of 1981 on July 17 of that year. Additional hearings were held on October 29, 1981. During the course of these

comparative performance of courts in cases filed under the respective chapters of the Code.

In an effort to begin compiling comprehensive comparative statistics which would provide the Congress with more complete information concerning the performance of the courts in the respective judicial districts, the bill contains a directive to the Director of the Administrative Office of the United States Courts to begin assembling information concerning assets and liabilities of debtors; amount of debt discharged in cases under each chapter of title 11; the total amount of disbursements to creditors by the bankruptcy courts, and time elapsed between case filings and payments to creditors.

All of the information required to be collected under Subtitle "H" of the bill would be available from records which will be available in the bankruptcy courts from petition and motion filings, and it is the belief of the Committee that the compilations requested will pose no unmanageable burden upon the Administrative Office. The Director, of course, has complete discretion in establishing the procedures by which the information shall be gathered.

I. Technical Amendments

On July 12, 1978, the Committee on the Judiciary reported S. 2266, the Senate version of the Bankruptcy Reform Act of 1978. On September 7, 1978, the Senate took from the desk H.R. 8200, the House version of the Bankruptcy Reform Act of 1978, struck the text of the bill and inserted in its place the text of S. 2266 and passed the bill as amended. On September 20, 1978, H.R. 8200, with further amendments was passed again by the House. On October 5, 1978, the Senate repassed H.R. 8200, with additional amendments. Finally, on October 6, 1978, the House accepted the final Senate changes and cleared the bill for signature. On November 6, 1978, the bill was signed into law with the designation Public Law 95-598, the Bankruptcy Reform Act of 1978.

Since the date of passage of the Act, judges, scholars, and bankruptcy practitioners have reviewed its provisions and numerous technical amendments and minor substantive changes have been suggested to clarify the intent of Congress.

On March 14, 1979, Senator DeConcini introduced S. 658 which embodied many of those recommendations. After additional revision, S. 658 was reported out of the Judiciary Committee on August 3, 1979, passed by unanimous consent of the Senate on September 7, 1979, and sent to the House. On September 22, 1980, the House with further amendments passed S. 658 by unanimous consent. On December 1, 1980, the Senate made additional amendments to the House-passed version of S. 658 and passed it by unanimous consent. On December 3, 1980 the House with further amendments passed S. 658 by unanimous consent. On December 9, 1980, the Senate with further amendments reintroduced the bill as S. 3259 and passed it by unanimous consent. Since the House during the remainder of the 96th Congress took no action on the final Senate changes, the bill was not enacted into law.

In the 97th Congress, on April 2, 1981, Senator Dole, with Senators Heflin and DeConcini as cosponsors, introduced S. 863, which

embodied all of the provisions of S. 3259, as passed by the Senate on December 1, 1980, with a few minor changes. On April 3 and 6, 1981, general oversight hearings on the Bankruptcy Code were held by the Subcommittee on Courts, at which time testimony in support of the bill's provisions was received.

On July 17, 1981, S. 863 was passed by the Senate. However, no action was taken on the bill by the House during the 97th Congress.

On January 24th, 1983, further hearings were held on needed amendments by the Judiciary Subcommittee on Courts. At the conclusion of hearings, Senator Dole introduced the substance of S. 863, with additional provisions, as Subtitle I of the Committee bill.

Significant provisions of Subtitle I are discussed in the sectional analysis which follows this summary of the bill contents.

IV. SUMMARY AND SECTIONAL ANALYSIS OF THE BILL

A. SUMMARY

The bill is divided into ten subtitles, the content of which are as follows:

Subt. A: *Consumer Credit Amendments*. Reformed procedures relating to consumer debtor cases.

Subt. B: *Grain Elevator Bankruptcy Amendments*. Text is drawn from S. 3037 in 97th Congress. Provides procedures for expedited abandonment of grain from bankrupt elevators.

Subt. C: *Shopping Centers Bankruptcy Amendments*. S. 2257 in 97th, S. 549 in 98th. Establishes a timetable within which trustee would have to accept or reject leases on shopping center properties in bankruptcy, and other purposes.

Subt. D: *Drunk Drivers' Nondischargeability of debts*. S. 2159 in 97th Congress. Prohibits debts incurred as a result of an act of drunk driving from being discharged in bankruptcy.

Subt. E: *Referee's Salary and Expense Fund Amendments*. (Drawn from S. 863 in 97th Congress). Corrects a drafting error in the 1978 Act which requires a handful of corporate debtors in bankruptcy to continue making payments to the non-existent fund.

Subt. F: *Repurchase Agreements Amendments*. Proposal of the Federal Reserve Board, which exempts repurchase agreements from the automatic stay in bankruptcy.

Subt. G: *Timesharing Agreements Amendments*. S. 3027 in the 97th Congress, S. 492 in the 98th. This subtitle provides that persons who hold timesharing agreements shall be granted a lien on the property involved when the timesharing contractor goes bankrupt and the trustee terminates the timesharing contract and other provisions.

Subt. H: *Bankruptcy Oversight*. This subtitle directs the Administrative Office to collect information on bankruptcy filings regarding levels of debtor income and assets, debtor living expenses, and total amounts recovered for creditors in proceedings under Chapters 7, 11, and 13. This information will assist Congress in analyzing the functioning of the bankruptcy system.

Subt. I: *Technical and Clarifying Amendments*. The bulk of the provisions in this subtitle are drawn from S. 863, which passed the

TAB 7

Calendar No. 192

97TH CONGRESS, 1st Session | SENATE | REPORT No. 97-150

BANKRUPTCY AMENDMENTS ACT OF 1981

JULY 10 (legislative day, JULY 8), 1981.—Ordered to be printed

Mr. THURMOND, from the Committee on the Judiciary, submitted the following

REPORT

[To accompany S. 863]

The Committee on the Judiciary, to which was referred the bill (S. 863) to correct technical errors, clarify, and make minor substantive changes to Public Law 95-598, the Bankruptcy Reform Act of 1978, having considered the same, reports favorably thereon with amendments and recommends that the bill as amended do pass.

PURPOSE OF THE AMENDMENT

The amendment is an amendment in the nature of a substitute and its purpose is identical to that of the bill as introduced: To correct technical errors, clarify and make minor substantive changes to Public Law 95-598.

PURPOSE OF THE BILL

The purpose of the bill is to correct technical errors, clarify and make minor substantive changes in Public Law 95-598, the Bankruptcy Reform Act of 1978.

INTRODUCTION

On July 12, 1978, the Committee on the Judiciary reported S. 2266, the Senate version of the Bankruptcy Reform Act of 1978. On September 7, 1978, the Senate took from the desk H.R. 8200, the House version of the Bankruptcy Reform Act of 1978, struck the text of the bill and inserted in its place the text of S. 2266 and passed the bill as amended. On September 20, 1978, H.R. 8200, with further amendments was passed again by the House. On October 5, 1978, the Senate repassed H.R. 8200, with additional amendments. Finally, on October 6, 1978, the House accepted the final Senate changes and cleared

the bill for signature by the President. On November 6, 1978, President Carter signed the bill and it became Public Law 95–598. Judge, scholars and bankruptcy practitioners have reviewed its provisions and numerous technical amendments and minor substantive changes to make clear the intent of Congress have been suggested to the Committee.

On March 14, 1979, Senator DeConcini introduced S. 658 which embodied many of those recommendations. After additional revision, S. 658 was reported out of the Judiciary Committee on August 3, 1979, passed by unanimous consent of the Senate on September 7, 1979, and sent to the House. On September 22, 1980, the House with further amendments passed S. 658 by unanimous consent. On December 1, 1980, the Senate made additional amendments to the House-passed version of S. 658 and passed it by unanimous consent. On December 3, 1980, the House with further amendments passed S. 658 by unanimous consent. On December 9, 1980, the Senate with further amendments reintroduced the bill as S. 3259 and passed it by unanimous consent. Since the House during the remainder of the 96th Congress took no action on the final Senate changes, the bill was not enacted into law.

In the 97th Congress, on April 2, 1981, Senator Dole, with Senators Heflin and DeConcini as cosponsors, introduced S. 863, which embodied all of the provisions of S. 3259, as passed by the Senate on December 1, 1980, with a few minor changes. On April 3 and 6, 1981, general oversight hearings on the Bankruptcy Code were held by the Subcommittee on Courts, at which time testimony in support of the bill's provisions was received.

Section-by-Section Analysis—Title I

The amendments contained in title I make amendments to title I of The Bankruptcy Reform Act of 1978, Public Law 95–598 ("the Reform Act"). In this title all section references within the section and subsection descriptions of the amendments will be to title I of the Reform Act unless otherwise indicated.

Section 1(a). This section deletes a redundancy. "Substantially all the property of the debtor" includes all of the property of the debtor and "all" can be deleted as redundant.

Subsection (b). This amendment corrects a typographical error.

Subsection (c). This amendment cross-references two additional sections to complete the intent that claims fixed after the filing of the petition are to be treated as pre-petition claims, and deletes the reference to present section 502(i), which is in effect repealed by section 80(g) of the bill.

Subsection (d). This amendment corrects a typographical error in definition of "entity".

Subsection (e). This amendment corrects a typographical error in the definition of "individual with regular income".

Subsection (f). This amendment to the definition of "insolvent" with respect to a partnership, clarifies that "separate" as used in the definition refers to the general partners' nonpartnership property, and removes the ambiguity that it might refer to his noncommunity property in a community property estate.

TAB 8

Calendar No. 192

97TH CONGRESS, 1st Session } SENATE { REPORT No. 97-150

BANKRUPTCY AMENDMENTS ACT OF 1981

JULY 10 (legislative day, JULY 6), 1981.—Ordered to be printed

Mr. THURMOND, from the Committee on the Judiciary, submitted the following

REPORT

[To accompany S. 863]

The Committee on the Judiciary, to which was referred the bill (S. 863) to correct technical errors, clarify, and make minor substantive changes to Public Law 95-598, the Bankruptcy Reform Act of 1978, having considered the same, reports favorably thereon with amendments and recommends that the bill as amended do pass.

PURPOSE OF THE AMENDMENT

The amendment is an amendment in the nature of a substitute and its purpose is identical to that of the bill as introduced: To correct technical errors, clarify and make minor substantive changes to Public Law 95-598.

PURPOSE OF THE BILL

The purpose of the bill is to correct technical errors, clarify and make minor substantive changes in Public Law 95-598, the Bankruptcy Reform Act of 1978.

INTRODUCTION

On July 12, 1978, the Committee on the Judiciary reported S. 2266, the Senate version of the Bankruptcy Reform Act of 1978. On September 7, 1978, the Senate took from the desk H.R. 8200, the House version of the Bankruptcy Reform Act of 1978, struck the text of the bill and inserted in its place the text of S. 2266 and passed the bill as amended. On September 20, 1978, H.R. 8200, with further amendments was passed again by the House. On October 5, 1978, the Senate repassed H.R. 8200, with additional amendments. Finally, on October 6, 1978, the House accepted the final Senate changes and cleared

standards of 1103(b) has meant significant hardship to creditors in retaining the best, most informed counsel. Experience under the Code, particularly in rural areas, has shown that the cure for the potential conflict has been at great cost and is in all likelihood worse than the disease. Present 1103(b) is an example of paternalism on the part of the Federal Government that is hardly needed in the context of chapter 11 bankruptcy proceedings between businessmen dealing at arm's length.

As a result of oversight hearings that dealt in part with this provision, the committee concludes that 1103(b) should be modified. As presently written, 1103(b) (1) assumes a conflict that usually does not exist (and which professional rules of ethics already ban); (2) excludes from administration of the bankruptcy estate those professionals who are most experienced and knowledgeable about the estate (i.e., those who are already representing individual creditors); (3) inhibits expeditious bankruptcy administration and increases the cost of administration; and (4) may inhibit out-of-court settlements which should be encouraged.

The Committee feels the amendment adequately meets the concerns of those who see a potential for conflict by precluding dual representation by those who have an adverse interest. The courts are fully capable of making this determination. The Committee also feels that mere representation by a person of one or more creditors of the same class as are represented by a creditors' committee also represented by that person shall not per se constitute the representation of an adverse interest. The court should not presume to know better than the affected creditors except in clear instances of potential impropriety.

Subsection (b). Paragraph (1) makes clear that the creditors' committee is not required to make recommendations with respect to the plan and may solicit rejections as well as acceptances. Paragraph (2) deletes redundant language in section 1103(c).

Section 95. This amendment makes a necessary grammatical change.

Section 96. This amendment gives the court explicit power to regulate the duties of an examiner.

Section 97. This amendment makes clarifying changes.

Section 98. This amendment makes a clarifying change. The court may not ex parte order the trustee or debtor in possession to cease operating the debtor's business.

Section 99. This amendment makes clear that a deficiency claim will be eliminated only when the secured creditor has had an opportunity to credit bid the claim. The amendment adds abandonment or surrender of the collateral to the secured creditor as the possible events that would eliminate the deficiency claim.

Section 100(a). This amendment makes a technical clarifying change and corrects a typographical error.

Subsection (b). This amendment makes stylistic changes.

Section 101(a). This amendment makes a grammatical change.

Subsection (b). This amendment makes a technical stylistic change.

Section 102(a). Paragraphs (1) through (5) make technical stylistic changes. Paragraph (6) makes clear that preferred stock without voting rights can be issued under the plan and the prohibition against issuing stock that cannot be voted extends only to common stock.

TAB 9

Calendar No. 102

98TH CONGRESS
1st Session | SENATE | REPORT
No. 98-65

OMNIBUS BANKRUPTCY IMPROVEMENTS ACT OF 1983

REPORT

OF THE

COMMITTEE ON THE JUDICIARY UNITED STATES SENATE

[To accompany S. 445]

[Together with Additional Views]

Ordered to be printed

U.S. GOVERNMENT PRINTING OFFICE
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Calendar No. 102

98TH CONGRESS 1st Session | SENATE | REPORT No. 98-65

OMNIBUS BANKRUPTCY IMPROVEMENTS ACT OF 1983

APRIL 26, 1983—Ordered to be printed

Mr. THURMOND, from the Committee on the Judiciary, submitted the following

REPORT

[To accompany S. 445]

The Committee on the Judiciary, which considered the bill (S. 445) to make certain substantive changes to Public Law 95-598, the Bankruptcy Reform Act of 1978, having considered the same, reports favorably thereon as amended and recommends that the bill as amended do pass.

I. PURPOSE OF THE BILL

The purpose of the bill is to make certain substantive changes in Public Law 95-598, the Bankruptcy Reform Act of 1978.

II. INTRODUCTION AND HISTORY OF THE BILL

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In the 97th Congress, the Subcommittee on Courts, chaired by Senator Dole, held general oversight hearings on the Bankruptcy Reform Act of 1978 on April 3 and 6, 1981. As a result of those hearings, numerous amendments, largely technical in nature, were proposed which were passed by the Senate as S. 863, the Bankruptcy Amendments Act of 1981 on July 17 of that year. Additional hearings were held on October 29, 1981. During the course of these

hearings, judges, scholars, and bankruptcy practitioners testified as to the effectiveness of the new Code as it applies to consumer debtors and suggested improvements. Comments centered upon provisions in Chapters 7 and 13 governing redemption of collateral, reaffirmation agreements, Federal exemptions, preferential transfers, and a number of additional procedural sections of the Code. Witnesses also raised questions concerning the statutorily mandated criteria for determining eligibility for bankruptcy, and certain witnesses requested committee consideration of various proposals to require the bankruptcy court to evaluate the future earnings capability of consumer petitioners in determining eligibility for Chapter 7 relief, while others opposed these proposals. At the hearings held in October, 1981, the Subcommittee on Courts explored the ramifications of these proposals.

On December 16, 1981, all of the Subcommittee members introduced S. 2000, which was favorably voted out of the Subcommittee on Courts, with an amendment in the nature of a substitute offered by Chairman Dole accepted thereto by a unanimous poll of February 12, 1982. The bill was placed on the Committee calendar early in March and was before the committee for several weeks prior to vote, during which time committee staff conducted discussions on areas of concern to members. As a result of these discussions, a number of amendments were accepted to S. 2000 with modifications prior to final Committee action. The Committee approved reporting of the bill with amendments by voice vote on April 20, 1982. Senators Kennedy and Metzenbaum requested that their votes be recorded in the negative, and the clerk was so instructed. No action was taken by the full Senate on S. 2000 during the 97th Congress.

On January 25, 1983, additional hearings were held and on February 3, 1983, Senator Dole introduced S. 445, which contained the provisions of S. 2000, in addition to provisions addressing other areas of proposed substantive amendments. Further hearings were held on S. 445 on April 6, 1983.

After these hearings and as a result of further discussions among Committee members, S. 445 was amended in several important respects. Provisions requiring debtors to file, with the court, statements of projected future earnings and expenses and authorizing the bankruptcy courts to dismiss Chapter 7 cases if debtors could pay a reasonable portion of their debts out of future income were deleted. Provisions for debtor counseling by the court-appointed trustee were added. S. 445 was also amended to include language authorizing courts—acting strictly on their own motion—to dismiss a case where the granting of Chapter 7 relief would represent a substantial abuse of that chapter. Further technical and clarifying amendments were made to sections of the bill dealing with grain elevators, shopping centers, and other technical matters.

On April 19, 1981, the Judiciary Committee approved reporting of the bill with the amendments agreed to.

During the course of Committee action on S. 445, Senators Dole, Heflin, Metzenbaum, Kennedy, Leahy, Baucus and DeConcini each played a critical role in shaping the legislation and in developing moderating language enhancing protections for debtors affected by changes in the law provided for in the bill.

comparative performance of courts in cases filed under the respective chapters of the Code.

In an effort to begin compiling comprehensive comparative statistics which would provide the Congress with more complete information concerning the performance of the courts in the respective judicial districts, the bill contains a directive to the Director of the Administrative Office of the United States Courts to begin assembling information concerning assets and liabilities of debtors; amount of debt discharged in cases under each chapter of title 11; the total amount of disbursements to creditors by the bankruptcy courts, and time elapsed between case filings and payments to creditors.

All of the information required to be collected under Subtitle "H" of the bill would be available from records which will be available in the bankruptcy courts from petition and motion filings, and it is the belief of the Committee that the compilations requested will pose no unmanageable burden upon the Administrative Office. The Director, of course, has complete discretion in establishing the procedures by which the information shall be gathered.

I. Technical Amendments

On July 12, 1978, the Committee on the Judiciary reported S. 2266, the Senate version of the Bankruptcy Reform Act of 1978. On September 7, 1978, the Senate took from the desk H.R. 8200, the House version of the Bankruptcy Reform Act of 1978, struck the text of the bill and inserted in its place the text of S. 2266 and passed the bill as amended. On September 20, 1978, H.R. 8200, with further amendments was passed again by the House. On October 5, 1978, the Senate repassed H.R. 8200, with additional amendments. Finally, on October 6, 1978, the House accepted the final Senate changes and cleared the bill for signature. On November 6, 1978, the bill was signed into law with the designation Public Law 95-598, the Bankruptcy Reform Act of 1978.

Since the date of passage of the Act, judges, scholars, and bankruptcy practitioners have reviewed its provisions and numerous technical amendments and minor substantive changes have been suggested to clarify the intent of Congress.

On March 14, 1979, Senator DeConcini introduced S. 658 which embodied many of those recommendations. After additional revision, S. 658 was reported out of the Judiciary Committee on August 3, 1979, passed by unanimous consent of the Senate on September 7, 1979, and sent to the House. On September 22, 1980, the House with further amendments passed S. 658 by unanimous consent. On December 1, 1980, the Senate made additional amendments to the House-passed version of S. 658 and passed it by unanimous consent. On December 3, 1980 the House with further amendments passed S. 658 by unanimous consent. On December 9, 1980, the Senate with further amendments reintroduced the bill as S. 3259 and passed it by unanimous consent. Since the House during the remainder of the 96th Congress took no action on the final Senate changes, the bill was not enacted into law.

In the 97th Congress, on April 2, 1981, Senator Dole, with Senators Heflin and DeConcini as cosponsors, introduced S. 863, which

embodied all of the provisions of S. 3259, as passed by the Senate on December 1, 1980, with a few minor changes. On April 3 and 6, 1981, general oversight hearings on the Bankruptcy Code were held by the Subcommittee on Courts, at which time testimony in support of the bill's provisions was received.

On July 17, 1981, S. 863 was passed by the Senate. However, no action was taken on the bill by the House during the 97th Congress.

On January 24th, 1983, further hearings were held on needed amendments by the Judiciary Subcommittee on Courts. At the conclusion of hearings, Senator Dole introduced the substance of S. 863, with additional provisions, as Subtitle I of the Committee bill.

Significant provisions of Subtitle I are discussed in the sectional analysis which follows this summary of the bill contents.

IV. SUMMARY AND SECTIONAL ANALYSIS OF THE BILL

A. SUMMARY

The bill is divided into ten subtitles, the content of which are as follows:

Subt. A: *Consumer Credit Amendments*. Reformed procedures relating to consumer debtor cases.

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Subt. D: *Drunk Drivers' Nondischargeability of debts*. S. 2159 in 97th Congress. Prohibits debts incurred as a result of an act of drunk driving from being discharged in bankruptcy.

Subt. E: *Referee's Salary and Expense Fund Amendments* (Drawn from S. 863 in 97th Congress). Corrects a drafting error in the 1978 Act which requires a handful of corporate debtors in bankruptcy to continue making payments to the non-existent fund.

Subt. F: *Repurchase Agreements Amendments*. Proposal of the Federal Reserve Board, which exempts repurchase agreements from the automatic stay in bankruptcy.

Subt. G: *Timesharing Agreements Amendments*. S. 3027 in the 97th Congress, S. 492 in the 98th. This subtitle provides that persons who hold timesharing agreements shall be granted a lien on the property involved when the timesharing contractor goes bankrupt and the trustee terminates the timesharing contract, and other provisions.

Subt. H: *Bankruptcy Oversight*. This subtitle directs the Administrative Office to collect information on bankruptcy filings regarding levels of debtor income and assets, debtor living expenses, and total amounts recovered for creditors in proceedings under Chapters 7, 11, and 13. This information will assist Congress in analyzing the functioning of the bankruptcy system.

Subt. I: *Technical and Clarifying Amendments*. The bulk of the provisions in this subtitle are drawn from S. 863, which passed the

TAB 10

Calendar No. 102

98TH CONGRESS
1st Session

SENATE

REPORT
No 98-65

OMNIBUS BANKRUPTCY IMPROVEMENTS ACT OF 1983

REPORT

OF THE

COMMITTEE ON THE JUDICIARY UNITED STATES SENATE

[To accompany S. 445]

[Together with Additional Views]

Ordered to be printed

U.S. GOVERNMENT PRINTING OFFICE
WASHINGTON : 1983

hearings, judges, scholars, and bankruptcy practitioners testified as to the effectiveness of the new Code as it applies to consumer debtors and suggested improvements. Comments centered upon provisions in Chapters 7 and 13 governing redemption of collateral, reaffirmation agreements, Federal exemptions, preferential transfers, and a number of additional procedural sections of the Code. Witnesses also raised questions concerning the statutorily mandated criteria for determining eligibility for bankruptcy, and certain witnesses requested committee consideration of various proposals to require the bankruptcy court to evaluate the future earnings capability of consumer petitioners in determining eligibility for Chapter 7 relief, while others opposed these proposals. At the hearings held in October, 1981, the Subcommittee on Courts explored the ramifications of these proposals.

On December 16, 1981, all of the Subcommittee members introduced S. 2000, which was favorably voted out of the Subcommittee on Courts, with an amendment in the nature of a substitute offered by Chairman Dole accepted thereto by a unanimous poll of February 12, 1982. The bill was placed on the Committee calendar early in March and was before the committee for several weeks prior to vote, during which time committee staff conducted discussions on areas of concern to members. As a result of these discussions, a number of amendments were accepted to S. 2000 with modifications prior to final Committee action. The Committee approved reporting of the bill with amendments by voice vote on April 20, 1982. Senators Kennedy and Metzenbaum requested that their votes be recorded in the negative, and the clerk was so instructed No action was taken by the full Senate on S. 2000 during the 97th Congress.

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On April 19, 1981, the Judiciary Committee approved reporting of the bill with the amendments agreed to.

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comparative performance of courts in cases filed under the respective chapters of the Code.

In an effort to begin compiling comprehensive comparative statistics which would provide the Congress with more complete information concerning the performance of the courts in the respective judicial districts, the bill contains a directive to the Director of the Administrative Office of the United States Courts to begin assembling information concerning assets and liabilities of debtors; amount of debt discharged in cases under each chapter of title 11; the total amount of disbursements to creditors by the bankruptcy courts, and time elapsed between case filings and payments to creditors.

All of the information required to be collected under Subtitle "H" of the bill would be available from records which will be available in the bankruptcy courts from petition and motion filings, and it is the belief of the Committee that the compilations requested will pose no unmanageable burden upon the Administrative Office. The Director, of course, has complete discretion in establishing the procedures by which the information shall be gathered.

I. Technical Amendments

On July 12, 1978, the Committee on the Judiciary reported S. 2266, the Senate version of the Bankruptcy Reform Act of 1978. On September 7, 1978, the Senate took from the desk H.R. 8200, the House version of the Bankruptcy Reform Act of 1978, struck the text of the bill and inserted in its place the text of S. 2266 and passed the bill as amended. On September 20, 1978, H.R. 8200, with further amendments was passed again by the House. On October 5, 1978, the Senate repassed H.R. 8200, with additional amendments. Finally, on October 6, 1978, the House accepted the final Senate changes and cleared the bill for signature. On November 6, 1978, the bill was signed into law with the designation Public Law 95-598, the Bankruptcy Reform Act of 1978.

Since the date of passage of the Act, judges, scholars, and bankruptcy practitioners have reviewed its provisions and numerous technical amendments and minor substantive changes have been suggested to clarify the intent of Congress.

On March 14, 1979, Senator DeConcini introduced S. 658 which embodied many of those recommendations. After additional revision, S. 658 was reported out of the Judiciary Committee on August 3, 1979, passed by unanimous consent of the Senate on September 7, 1979, and sent to the House. On September 22, 1980, the House with further amendments passed S. 658 by unanimous consent. On December 1, 1980, the Senate made additional amendments to the House-passed version of S. 658 and passed it by unanimous consent. On December 3, 1980 the House with further amendments passed S. 658 by unanimous consent. On December 9, 1980, the Senate with further amendments reintroduced the bill as S. 3259 and passed it by unanimous consent. Since the House during the remainder of the 96th Congress took no action on the final Senate changes, the bill was not enacted into law.

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embodied all of the provisions of S. 3259, as passed by the Senate on December 1, 1980, with a few minor changes. On April 3 and 6, 1981, general oversight hearings on the Bankruptcy Code were held by the Subcommittee on Courts, at which time testimony in support of the bill's provisions was received.

On July 17, 1981, S. 863 was passed by the Senate. However, no action was taken on the bill by the House during the 97th Congress.

On January 24th, 1983, further hearings were held on needed amendments by the Judiciary Subcommittee on Courts. At the conclusion of hearings, Senator Dole introduced the substance of S. 863, with additional provisions, as Subtitle I of the Committee bill.

Significant provisions of Subtitle I are discussed in the sectional analysis which follows this summary of the bill contents.

IV. SUMMARY AND SECTIONAL ANALYSIS OF THE BILL

A. SUMMARY

The bill is divided into ten subtitles, the content of which are as follows:

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Subt. C: *Shopping Centers Bankruptcy Amendments.* S. 2297 in 97th, S. 549 in 98th. Establishes a timetable within which trustee would have to accept or reject leases on shopping center properties in bankruptcy, and other purposes.

Subt. D: *Drunk Drivers' Nondischargeability of debts.* S. 2158 in 97th Congress. Prohibits debts incurred as a result of an act of drunk driving from being discharged in bankruptcy.

Subt. E: *Referee's Salary and Expense Fund Amendments* (Drawn from S. 863 in 97th Congress). Corrects a drafting error in the 1978 Act which requires a handful of corporate debtors in bankruptcy to continue making payments to the non-existent fund.

Subt. F: *Repurchase Agreements Amendments.* Proposal of the Federal Reserve Board, which exempts repurchase agreements from the automatic stay in bankruptcy.

Subt. G: *Timesharing Agreements Amendments.* S. 3027 in the 97th Congress, S. 492 in the 98th. This subtitle provides that persons who hold timesharing agreements shall be granted a lien on the property involved when the timesharing contractor goes bankrupt and the trustee terminates the timesharing contract, and other provisions.

Subt. H: *Bankruptcy Oversight.* This subtitle directs the Administrative Office to collect information on bankruptcy filings regarding levels of debtor income and assets, debtor living expenses, and total amounts recovered for creditors in proceedings under Chapters 7, 11, and 13. This information will assist Congress in analyzing the functioning of the bankruptcy system.

Subt. I: *Technical and Clarifying Amendments.* The bulk of the provisions in this subtitle are drawn from S. 863, which passed the

Senate by unanimous consent in 1981. The provisions correct grammatical, punctuation, and spelling errors in the code, clarify the intent of the drafters in certain sections, and generally refine procedures.

Subt. J: *Severance clause, effective dates.*

B. SECTIONAL ANALYSIS

1. Subtitle A

Sec. 201: Title.

Sec. 202(a)&(b): These sections amend sections 301 and 302 of title 11 for the purpose of creating a mechanism by which individual debtors in bankruptcy can obtain the protections of the automatic stay pending the completion of debtor counseling as provided for in Section 203 of the bill. Under the provisions of the bill, debtors would commence a case under Chapter 7 by filing a petition with the court which contains an initial designation of relief under that chapter. Upon the filing of such a petition, the debtor would have all the rights, including the right to the protections of the automatic stay, that would have been available under prior law and that would exist if the debtor were to make Chapter 7 his final designation. Similarly, a debtor would commence a case under Chapter 13 by filing a petition with the initial designation that relief was sought under that Chapter, and would have all the rights, including the right to the protections of the automatic stay, that would have been available under prior law and that would exist if the debtor were to make Chapter 13 his final designation. The only reason for referring to the initial designation as conditional is to assure that debtors receive counseling before making a final decision on whether to proceed under Chapter 7 or Chapter 13 in accordance with the new 521(a)(3) of title 11.

Sec. 202(c): This section authorizes a court to dismiss a case brought under Chapter 7 if the filing represents a substantial abuse of that Chapter. Under this provision, the court may not dismiss a case in response to a request or suggestion from any party in interest, nor may a party in interest make such a request or suggestion. Instead, the case may be dismissed only where the court acting independently on its own motion, finds substantial abuse and in such case, the court must make an express finding of substantial abuse.

This provision represents a balancing of two interests. It preserves the fundamental concept embodied in our bankruptcy laws that debtors who cannot meet debts as they come due should be able to relinquish non-exempt property in exchange for a fresh start. At the same time, however, it upholds creditors' interests in obtaining repayment where such repayment would not be a burden.

Crushing debt burdens and severe financial problems place enormous strains on borrowers and their families. Family life, personal emotional health, or work productivity often suffers. By enabling individuals who cannot meet their debts to start a new life, unburdened with debts they cannot pay, the bankruptcy laws allow troubled borrowers to become productive members of their communities. Nothing in this bill denies such borrowers with unaffordable

TAB 11

Calendar No. 102

98TH CONGRESS 1st Session | SENATE | REPORT No. 98-65

OMNIBUS BANKRUPTCY IMPROVEMENTS ACT OF 1983

APRIL 26, 1983—Ordered to be printed

Mr. THURMOND, from the Committee on the Judiciary, submitted the following

REPORT

[To accompany S. 445]

The Committee on the Judiciary, which considered the bill (S. 445) to make certain substantive changes to Public Law 95-598, the Bankruptcy Reform Act of 1978, having considered the same, reports favorably thereon as amended and recommends that the bill as amended do pass.

I. PURPOSE OF THE BILL

The purpose of the bill is to make certain substantive changes in Public Law 95-598, the Bankruptcy Reform Act of 1978.

II. INTRODUCTION AND HISTORY OF THE BILL

On July 12, 1978, the Committee on the Judiciary reported S. 2226, the Senate version of the Bankruptcy Reform Act of 1978. On September 20, 1978, H.R. 8200, with further amendments, was passed again by the House. On October 5, 1978, the Senate repassed H.R. 8200, with additional amendments. Finally, on October 6, 1978, the House accepted the final Senate changes and cleared the bill for signature by the President. On November 6, 1978, President Carter signed the bill and it became Public Law 95-598. On October 1, 1979, Public Law 95-598, styled the Bankruptcy Reform Act of 1978, went into effect.

In the 97th Congress, the Subcommittee on Courts, chaired by Senator Dole, held general oversight hearings on the Bankruptcy Reform Act of 1978 on April 3 and 6, 1981. As a result of those hearings, numerous amendments, largely technical in nature, were proposed which were passed by the Senate as S. 863, the Bankruptcy Amendments Act of 1981 on July 17 of that year. Additional hearings were held on October 29, 1981. During the course of these

embodied all of the provisions of S. 3259, as passed by the Senate on December 1, 1980, with a few minor changes. On April 5 and 6, 1981, general oversight hearings on the Bankruptcy Code were held by the Subcommittee on Courts, at which time testimony in support of the bill's provisions was received.

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Senate by unanimous consent in 1981. The provisions correct grammatical, punctuation, and spelling errors in the code, clarify the intent of the drafters in certain sections, and generally refine procedures.

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B. SECTIONAL ANALYSIS

1. Subtitle A

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Sec. 202(c): This section authorizes a court to dismiss a case brought under Chapter 7 if the filing represents a substantial abuse of that Chapter. Under this provision, the court may not dismiss a case in response to a request or suggestion from any party in interest, nor may a party in interest make such a request or suggestion. Instead, the case may be dismissed only where the court, acting independently on its own motion, finds substantial abuse and in such case, the court must make an express finding of substantial abuse.

This provision represents a balancing of two interests. It preserves the fundamental concept embodied in our bankruptcy laws that debtors who cannot meet debts as they come due should be able to relinquish non-exempt property in exchange for a fresh start. At the same time, however, it upholds creditors' interests in obtaining repayment where such repayment would not be a burden.

Crushing debt burdens and severe financial problems place enormous strains on borrowers and their families. Family life, personal emotional health, or work productivity often suffers. By enabling individuals who cannot meet their debts to start a new life, unburdened with debts they cannot pay, the bankruptcy laws allow troubled borrowers to become productive members of their communities. Nothing in this bill denies such borrowers with unaffordable

and may solicit rejections as well as acceptances. Paragraph (2) deletes redundant language in section 1103(c).

Sec. 398: This amendment makes a necessary grammatical change.

Sec. 399: This amendment gives the court explicit power to regulate the duties of an examiner.

Sec. 400: This amendment makes clarifying changes.

Sec. 401: This amendment makes a clarifying change. The court may not ex parte order the trustee or debtor in possession to cease operating the debtor's business.

Sec. 402: This amendment makes clear that a deficiency claim will be eliminated only when the secured creditor has had an opportunity to credit bid the claim. The amendment adds abandonment or surrender of the collateral to the secured creditor as the possible events that would eliminate the deficiency claim.

Sec. 403: (a). This amendment makes a technical clarifying change and corrects a typographical error.

Subsection (b). this amendment makes stylistic changes.

Sec. 404: (a). This amendment makes a grammatical change.

Subsection (b). This amendment makes a technical stylistic change.

Sec. 405: (a). Paragraphs (1) through (5) make technical stylistic changes.

Subsection (b). This amendment makes necessary stylistic changes.

Sec. 406: This amendment makes stylistic changes.

Sec. 407: (a). This amendment makes clarifying amendments

Subsection (b). This amendment makes clarifying amendments.

Subsection (c). This amendment makes stylistic changes.

Sec. 408: (a). This amendment corrects a cross-referencing error.

Subsection (b). This amendment makes a stylistic change.

Subsection (c). This amendment makes typographical stylistic changes.

Subsection (d). This amendment makes a necessary clarifying change in section 1126(g).

Sec. 409: (a). This amendment makes stylistic changes.

Subsection (b). This amendment makes stylistic changes.

Sec. 410: (a). Paragraphs (1) through (6) make clarifying and stylistic changes. Paragraph (7) makes a stylistic change. The Code is keyed to "holders of claims" for style as opposed to "creditors." Paragraph (9) makes clear that a government taxing unit may be required to accept certain tax payments over a period of six (6) years following confirmation of a plan of reorganization. The extension provisions are broadened to include taxes that result from the sale of a capital asset, the recapture of an investment tax credit, the recapture of depreciation, or a similar event. This provision is particularly important in a reorganization plan where the debtor has for a period of years had substantial unrealized income as a result of capital gain. This is common in the instance where a farmer seeks to reorganize and use the sale of all or a major part of his farm to pay the debts provided for under the plan of reorganization. Without this sort of provision, the capital gains taxes due upon the sale of the farm are immediately due upon confirmation

TAB 1

Citation
A&P Sen. 445 05/05/83
Sen. 445, 98th Cong., 1st Sess.
(Cite as: A&P SEN. 445)

Search Result Rank(R) 4 of 14 Database BANKR84-LH

Arnold & Porter Legislative History: P.L. 98-353

BILLS

IN THE HOUSE OF REPRESENTATIVES

S. 445
AN ACT To amend title 11, United States Code, and for other purposes.
May 5, 1983

*1 1 Be it enacted by the Senate and House of Representa-
2 tives of the United States of America in Congress assembled,
3 That this Act may be cited as the "Omnibus Bankruptcy Im-
4 provements Act of 1983".
5 TITLE I-BANKRUPTCY CODE AMENDMENTS
6 Subtitle A-Consumer Credit Amendments
7 SEC. 201. This subtitle may be cited as the "Consumer
8 Debtor Bankruptcy Amendments Act of 1983".
9 SEC. 202. (a) Section 301 of title 11 of the United
States Code, is amended-
1 (1) by striking out "A voluntary" and inserting in
2 lieu thereof "(a) For a debtor who is not an individual,
3 a voluntary"; and
4 (2) by adding at the end thereof the following new
5 subsection:
6 "(b) With respect to an individual debtor or debtors, a
7 voluntary case under this title is commenced by the filing
8 with the bankruptcy court of a petition which conditionally
9 designates a chapter under which relief is sought. The filing
10 of such a petition shall constitute an order for relief under the
11 provisions of the chapter conditionally designated. A final
12 designation of the chapter under which relief is sought shall
13 be made within the time period specified in section 521 of
14 this title.".
15 (b) Section 302(a) of title 11, United States Code, is
16 amended to read as follows:
17 "(a) A joint case under this title is commenced by the
18 filing, with the bankruptcy court, of a single petition pursuant
19 to section 301(b) by an individual and such individual's
20 spouse. The commencement of a joint case under a chapter of
21 this title constitutes an order for relief under the chapter con
22 ditionally designated in accordance with section 301(b).".
23 SEC. 203. (a) Section 305 of title 11 of the United
24 States Code is amended by adding at the end thereof the
25 following new subsection:
1 "(d)(1) Subject to the provisions of paragraph (2), the
2 court on its own motion according to procedures established
3 by rule, and not at the request or suggestion of any party in

17 thirds in amount and more than one-half in number of
18 allowed claims of such class, to be governed by subpar-
19 agraph (B) of this paragraph; and
20 "(B) unless the aggregate value of the interests in
21 such property of the holders of such claims is inconse-
22 quential, the class may elect, as provided under sub-
23 paragraph (A) of this paragraph, that such claims of
24 such class, whether or not the holders of such claims
25 had recourse against the debtor and notwithstanding
*112 1 section 506(a) of this title, are secured claims to the
2 full extent that such claims are allowed.
3 "(2) The provisions of paragraph (1) of this subsection
4 are limited to the purposes of this chapter and such para-
5 graph shall not in any other way alter, affect, or create any
6 right or liability of or in any other entity who may be liable
7 with the debtor on a debt to which the provisions of such
8 paragraph apply.".
9 SEC. 403. (a) Section 1112(a) of title 11 of the United
10 States Code is amended-
11 (1) in paragraph (2), by striking out "is an invol-
12 untary case originally commenced under this chapter"
and inserting in lieu thereof "originally was com-
menced as an involuntary case under this chapter";
15 and
16 (2) in paragraph (3), by striking out "on other
17 than" and inserting in lieu thereof "other than on".
18 (b) Section 1112(b) of title 11 of the United States Code
19 is amended-
20 (1) in paragraph (5), by inserting "a request made
21 for" before "additional"; and
22 (2) in paragraph (8), by striking out "and" and in-
23 serting in lieu thereof "or".
24 SEC. 404. (a) Section 1121(c)(3) of title 11 of the United
25 States Code is amended by striking out "the claims or inter-
*113 1 ests of which are" and inserting in lieu thereof "of claims or
2 interests that is".
3 (b) Section 1121(d) of title 11 of the United States Code
4 is amended by inserting "made within the respective periods
5 specified in subsection (c) of this section" after "interest".
6 SEC. 405. (a) Section 1123(a) of title 11 of the United
7 States Code is amended-
8 (1) by striking out "A" and inserting in lieu
9 thereof "Notwithstanding any otherwise applicable
10 nonbankruptcy law, a";
11 (2) in paragraph (1), by inserting commas after
12 "classes of claims" and after "507(a)(7) of this title";
13 (3) in paragraph (3), by striking out "shall";
(4) in paragraph (5), by striking out "execution"
and inserting in lieu thereof "implementation"; and
16 (5) in paragraph (5)(G), by inserting "of" after

17 "waiving".
18 (b) Section 1123(b)(2) of title 11 of the United States
19 Code is amended by-
20 (1) striking out "or rejection" and inserting in lieu
21 thereof ", rejection, or assignment"; and
22 (2) striking out "under section 365 of this title"
23 and inserting in lieu thereof "under such section".
24 SEC. 406. Section 1124 of title 11 of the United States
25 Code is amended-
*114 1 (1) by amending paragraph (2)(A) to read as fol-
2 lows:
3 "(A) cures any such default that occurred before
4 or after the commencement of the case under this title,
5 other than a default of a kind specified in section
6 365(b)(2) of this title;"; and
7 (2) in paragraph (3)(B)(i), by striking out "and"
8 and inserting in lieu thereof "or".
9 SEC. 407. (a) Section 1125(a) of title 11 of the United
10 States Code is amended-
11 (1) in paragraph (1), by inserting ", but need not
12 include such information about any other possible or
13 proposed plan" after "plan";
14 (2) in paragraph (2)(B), by inserting "the" after
15 "with"; and
16 (3) in paragraph (2)(C), by inserting "of" after
17 "holders".
18 (b) Section 1125(d) of title 11 of the United States Code
19 is amended by-
20 (1) inserting "required under subsection (b) of this
21 section" after "statement" the first place it appears;
22 and
23 (2) inserting ", or otherwise seek review of," after
24 "appeal from".
*115 1 (c) Section 1125(e) of title 11 of the United States Code
2 is amended by-
3 (1) inserting "acceptance or rejection of a plan"
4 after "solicits"; and
5 (2) inserting "solicitation of acceptance or rejec-
6 tion of a plan or" after "governing".
7 SEC. 408. (a) Section 1126(b)(2) of title 11 of the
8 United States Code is amended by striking out "1125(a)(1)"
9 and inserting in lieu thereof "1125(a)".
10 (b) Section 1126(d) of title 11 of the United States Code
11 is amended by inserting a comma after "such interests" the
12 first place it appears.
13 (c) Section 1126(f) of title 11 of the United States Code
14 is amended by-
15 (1) striking out "is deemed" and inserting in lieu
16 thereof ", and each holder of a claim or interest of
17 such class, are deemed";

TAB 13

Location Search Result Rank(R) 4 of 10 Database
A&P H.R. REP. 98-882 BANKR84-LH
H.R. Rep. No. 882, 98th Cong., 2d Sess. 1984
(Cite as: A&P H.R. REP. 98-882)

Arnold & Porter Legislative History: P.L. 98-353

REPORTS

Bankruptcy Amendments of 1984
June 29, 1984

[To accompany H.R. 5174]
*1 Mr. Rodino, from the committee of conference, submitted the following

CONFERENCE REPORT

The committee of conference on the disagreeing votes of the two Houses on the amendment of the Senate to the bill (H.R. 5174) to provide for the appointment of United States Bankruptcy judges under article III of the Constitution, to amend title 11 of the United States Code for the purpose of making certain changes in the personal bankruptcy law, of making certain changes regarding grain storage facilities, and of clarifying the circumstance which collective bargaining agreements may be rejected in cases under chapter 11, and for other purposes, having met, after full and free conference, have agreed to recommend and do recommend to their respective Houses as follows:
That the House recede from its disagreement to the amendment of the Senate to the text of the bill and agree to the same with an amendment as follows:
In lieu of the matter proposed to be inserted by the Senate amendment insert the following:

That this Act may be cited as the "Bankruptcy Amendments and Federal Judgeship Act of 1984".

TITLE I--BANKRUPTCY JURISDICTION AND PROCEDURE

Sec. 101. (a) Section 1334 of title 28, United States Code, is amended to read as follows:

"s 1334. Bankruptcy cases and proceedings

"(a) Except as provided in subsection (b) of this section, the district courts shall have original and exclusive jurisdiction of all cases under title 11.
*2 "(b) Notwithstanding any Act of Congress that confers exclusive jurisdiction on a court or courts other than the district courts, the district courts shall have original but not exclusive jurisdiction of all civil proceedings arising under title 11, or arising in or related to cases under title 11.
"(c)(1) Nothing in this section prevents a district court in the interest of justice, or in the interest of comity with State courts or respect for State law, from abstaining from hearing a particular proceeding arising under title 11, arising in or related to a case under title 11.
(2) Upon timely motion of a party in a proceeding based upon a State law claim or State law cause of action, related to a case under title 11 but not arising

Sec. 500. (a) Section 1103(b) is amended by--
(1) inserting "having an adverse interest" after "entity"; and
(2) adding at the end thereof the following: "Representation of one or more creditors of the same class as represented by the committee shall not per se constitute the representation of an adverse interest.".
(b) Section 1103(c) of title 11 of the United States Code is amended--
(1) in paragraph (3), by--
*56 (A) striking out "recommendations" and inserting in lieu thereof "determinations"; and
(B) inserting "or rejections" after "acceptances"; and
(2) in paragraph (4), by striking out ", if a trustee or examiner, as the case may be, has not previously been appointed under this chapter in the case".
Sec. 501. Section 1105 of title 11 of the United States Code is amended by striking out "estate, and" and inserting in lieu thereof "estate and of the".
Sec. 502. Section 1106(b) of title 11 of the United States Code is amended by inserting ", except to the extent that the court orders otherwise," before "any other".
Sec. 503. Section 1107(a) of title 11 of the United States Code is amended by inserting "serving in a case" after "on a trustee".
Sec. 504. Section 1108 of title 11 of the United States Code is amended by inserting ", on request of a party in interest and after notice and a hearing," after "court".
Sec. 505. (a) Section 1112(a) of title 11 of the United States Code is amended--
(1) in paragraph (2), by striking out "is an involuntary case originally commenced under this chapter" and inserting in lieu thereof "originally was commenced as an involuntary case under this chapter"; and
(2) in paragraph (3), by striking out "on other than" and inserting in lieu thereof "other than on".
(b) Section 1112(b) of title 11 of the United States Code is amended--
(1) in paragraph (5), by inserting "a request made for" before "additional"; and
(2) in paragraph (8), by striking out "and" and inserting in lieu thereof "or".
Sec. 506. (a) Section 1121(c)(3) of title 11 of the United States Code is amended by striking out "the claims or interests of which are" and inserting in lieu thereof "of claims or interests that is".
(b) Section 1121(d) of title 11 of the United States Code is amended by inserting "made within the respective periods specified in subsection (c) of this section" after "interest".
Sec. 507. (a) Section 1123(a) of title 11 of the United States Code is amended--
(1) by striking out "A" and inserting in lieu thereof "Notwithstanding any otherwise applicable nonbankruptcy law, a";
(2) in paragraph (1), by--
(A) inserting a comma after "classes of claims"; and
(B) by striking out "507(a)(6) of this title" and inserting in lieu thereof "507(a)(7) of this title,";
(3) in paragraph (3), by striking out "shall";
(4) in paragraph (5), by striking out "execution" and inserting in lieu

thereof "implementation"; and
(5) in paragraph (5)(G), by inserting "of" after "waiving".
(b) Section 1123(b)(2) of title 11 of the United States Code is amended by--
(1) striking out "or rejection" and inserting in lieu thereof ", rejection, or assignment"; and
*57 (2) striking out "under section 365 of this title" and inserting in lieu thereof "under such section".
Sec. 508. Section 1124 of title 11 of the United States Code is amended--
(1) by amending paragraph (2)(A) to read as follows:
"(A) cures any such default that occurred before or after the commencement of the case under this title, other than a default of a kind specified in section 365(b)(2) of this title;"; and
(2) in paragraph (3)(B)(i), by striking out "and" and inserting in lieu thereof "or".
Sec. 509. (a) Section 1125(a) of title 11 of the United States Code is amended--
(1) in paragraph (1), by inserting ", but adequate information need not include such information about any other possible or proposed plan" after "plan";
(2) in paragraph (2)(B), by inserting "the" after "with"; and
(3) in paragraph (2)(C), by inserting "of" after "holders".
(b) Section 1125(d) of title 11 of the United States Code is amended by
(1) inserting "required under subsection (b) of this section" after "statement" the first place it appears; and
(2) inserting ", or otherwise seek review of," after "appeal from".
(c) Section 1125(e) of title 11 of the United States Code is amended by--
(1) inserting "acceptance or rejection of a plan" after "solicits"; and
(2) inserting "solicitation of acceptance or rejection of a plan or" after "governing".
Sec. 510. (a) Section 1126(b)(2) of title 11 of the United States Code is amended by striking out "1125(a)(1)" and inserting in lieu thereof "1125(a)".
(b) Section 1126(d) of title 11 of the United States Code is amended by inserting a comma after "such interests" the first place it appears.
(c) Section 1126(f) of title 11 of the United States Code is amended by--
(1) striking out "is deemed" and inserting in lieu thereof ", and each holder of a claim or interest of such class, are conclusively presumed";
(2) striking out "solicitation" and inserting in lieu thereof "solicitation"; and
(3) striking out "interest" and inserting in lieu thereof "interests".
(d) Section 1126(g) of title 11 of the United States Code is amended by striking out "any payment or compensation" and inserting in lieu thereof "receive or retain any property".
Sec. 511. (a) Section 1127(a) of title 11 of the United States Code is amended by--
(1) inserting "of a plan" after "After the proponent"; and
(2) inserting "of such plan" after "modification".
(b) Section 1127(b) of title 11 of the United States Code is amended by striking out "the court, after notice and a hearing, confirms *58 such plan, as modified, under section 1129 of this title, and circumstances warrant such modification" and inserting in lieu thereof "circumstances warrant such

TAB 14

LEGISLATIVE HISTORY
P.L. 98-353

BANKRUPTCY AMENDMENTS AND FEDERAL JUDGESHIP ACT OF 1984

P.L. 98-353, see page 98 Stat. 333

House Conference Report No., 98-882
June 29, 1984 [To accompany H.R. 5174]

Cong. Record Vol. 130 (1984)

DATES OF CONSIDERATION AND PASSAGE

House March 21, June 29, 1984

Senate June 19, 29, 1984

No Senate Report or House Report was submitted with this legislation. The House Conference Report did not contain a Joint Explanatory Statement. Statements by Legislative Leaders are set out.

STATEMENTS BY LEGISLATIVE LEADERS

STATEMENT BY THE HON. PETER W. RODINO, JR., CHAIRMAN OF THE HOUSE COMMITTEE ON THE JUDICIARY, UPON THE CONSIDERATION OF THE CONFERENCE REPORT ON H.R. 5174.

130 Congressional Record H 7489, June 29, 1984

Mr. Speaker, today, to the surprise, amazement and relief of many, I am sure, if not all, I rise to take up the result of the conference on H.R. 5174, the bankruptcy amendments and Federal Judgeship Act of 1984.

Let me quickly outline the provisions of our agreement. As all of us know, that is a very complex, complicated measure. Title I creates a new bankruptcy court arrangement to replace the provisions enacted in the Bankruptcy Reform Act of 1978—Public Law 95-598—which were found unconstitutional by the U.S. Supreme Court in the case of *Northern Pipeline v. Marathon Pipeline Co.*, 458 U.S. 50 (1982).

The conferees adopted most of the provisions creating this new bankruptcy court arrangement that were contained in the bill passed by this body.

Title II creates 85 additional district court and court of appeals article III judgeships. Forty of these positions are to take effect in 1984 and forty-five are to take effect in 1985.

Title III provides for certain amendments to title II of the United States Code which is the Bankruptcy Code. This body and the other body agreed to the amendments contained in subtitle A of title III, commonly referred to as the consumer credit amendments. Identical provisions were passed by both bodies, and the conferees did not alter the consumer credit amendments. These amendments are fair to both debtors and creditors, and contain no threshold or future income test.

Subtitle B of title III contains amendments relating to a grain storage facility bankruptcy. Each body passed very similar grain elevator provisions. The conferees adopted the other body's language.

TAB 15

PUBLIC LAW 98-353 [H.R. 5174]: July 10, 1984

BANKRUPTCY AMENDMENTS AND FEDERAL JUDGESHIP ACT OF 1984

For Legislative History of Act, see p. 578

An Act to amend title 28 of the United States Code regarding jurisdiction of bankruptcy proceedings, to establish new Federal judicial positions, to amend title 11 of the United States Code, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That this Act may be cited as the "Bankruptcy Amendments and Federal Judgeship Act of 1984".

Bankruptcy Amendments and Federal Judgeship Act of 1984.
28 USC 151 note.

TITLE I—BANKRUPTCY JURISDICTION AND PROCEDURE

SEC. 101. (a) Section 1334 of title 28, United States Code, is amended to read as follows:

"§ 1334. Bankruptcy cases and proceedings

"(a) Except as provided in subsection (b) of this section, the district courts shall have original and exclusive jurisdiction of all cases under title 11.

11 USC 101 et seq.

"(b) Notwithstanding any Act of Congress that confers exclusive jurisdiction on a court or courts other than the district courts, the district courts shall have original but not exclusive jurisdiction of all civil proceedings arising under title 11, or arising in or related to cases under title 11.

"(c)(1) Nothing in this section prevents a district court in the interest of justice, or in the interest of comity with State courts or respect for State law, from abstaining from hearing a particular proceeding arising under title 11 or arising in or related to a case under title 11.

"(2) Upon timely motion of a party in a proceeding based upon a State law claim or State law cause of action, related to a case under title 11 but not arising under title 11 or arising in a case under title 11, with respect to which an action could not have been commenced in a court of the United States absent jurisdiction under this section, the district court shall abstain from hearing such proceeding if an action is commenced, and can be timely adjudicated, in a State forum of appropriate jurisdiction. Any decision to abstain made under this subsection is not reviewable by appeal or otherwise. This subsection shall not be construed to limit the applicability of the stay provided for by section 362 of title 11, United States Code, as such section applies to an action affecting the property of the estate in bankruptcy.

"(d) The district court in which a case under title 11 is commenced or is pending shall have exclusive jurisdiction of all of the property, wherever located, of the debtor as of the commencement of such case, and of the estate.".

Gifts and property.

(b) The table of sections for chapter 85 of title 28, United States Code, is amended by amending the item relating to section 1334 to read as follows:

"1334. Bankruptcy cases and proceedings".

(1) in paragraph (2), by striking out "is an involuntary case originally commenced under this chapter" and inserting in lieu thereof "originally was commenced as an involuntary case under this chapter"; and

(2) in paragraph (3), by striking out "on other than" and inserting in lieu thereof "other than on".

(b) Section 1112(b) of title 11 of the United States Code is amended—

(1) in paragraph (5), by inserting "a request made for" before "additional"; and

(2) in paragraph (8), by striking out "and" and inserting in lieu thereof "or".

SEC. 506. (a) Section 1121(c)(3) of title 11 of the United States Code is amended by striking out "the claims or interests of which are" and inserting in lieu thereof "of claims or interests that is".

(b) Section 1121(d) of title 11 of the United States Code is amended by inserting "made within the respective periods specified in subsection (c) of this section" after "interest".

SEC. 507. (a) Section 1123(a) of title 11 of the United States Code is amended—

(1) by striking out "A" and inserting in lieu thereof "Notwithstanding any otherwise applicable nonbankruptcy law, a";

(2) in paragraph (1), by—

(A) inserting a comma after "classes of claims"; and

(B) by striking out "507(a)(6) of this title" and inserting in lieu thereof "507(a)(7) of this title,";

(3) in paragraph (3), by striking out "shall";

(4) in paragraph (5), by striking out "execution" and inserting in lieu thereof "implementation"; and

(5) in paragraph (5)(G), by inserting "of" after "waiving".

(b) Section 1123(b)(2) of title 11 of the United States Code is amended by—

(1) striking out "or rejection" and inserting in lieu thereof ", rejection, or assignment"; and

(2) striking out "under section 365 of this title" and inserting in lieu thereof "under such section".

SEC. 508. Section 1124 of title 11 of the United States Code is amended—

(1) by amending paragraph (2)(A) to read as follows:

"(A) cures any such default that occurred before or after the commencement of the case under this title, other than a default of a kind specified in section 365(b)(2) of this title;"; and Ante p. 361

(2) in paragraph (3)(B)(i), by striking out "and" and inserting in lieu thereof "or".

SEC. 509. (a) Section 1125(a) of title 11 of the United States Code is amended—

(1) in paragraph (1), by inserting ", but adequate information need not include such information about any other possible or proposed plan" after "plan";

(2) in paragraph (2)(B), by inserting "the" after "with"; and

(3) in paragraph (2)(C), by inserting "of" after "holders".

(b) Section 1125(d) of title 11 of the United States Code is amended by—

(1) inserting "required under subsection (b) of this section" after "statement" the first place it appears; and

EXHIBIT B

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UNITED STATES DISTRICT 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. 01-2490 VRW (Bankruptcy Case No. 01-30923 DM; Adv. Proceeding No. 01-3072 DM) Chapter 11 Case
PACIFIC GAS AND ELECTRIC COMPANY, a California corporation, Plaintiff, Appellant, and Cross-Appellee, - against - CALIFORNIA PUBLIC UTILITIES COMMISSION, and LORETTA M. LYNCH, HENRY M. DUQUE, RICHARD A. BILAS, CARL W. WOOD, and GEOFFREY F. BROWN, in their official capacities as Commissioners of the California Public Utilities Commission. Defendants, Appellees, and Cross-Appellants.	**CROSS-APPELLANTS' REPLY BRIEF AND OPPOSITION TO SUPPLEMENTAL REQUEST FOR JUDICIAL NOTICE BY APPELLANT AND CROSS-APPELLEE PACIFIC GAS AND ELECTRIC COMPANY**

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PRELIMINARY STATEMENT

In its opening brief, the Commission showed that PG&E's claims against the Commissioners do not fit within the narrow exception to Eleventh Amendment immunity created by *Ex parte Young*, 209 U.S. 23 (1908). PG&E's opposition brief on appeal ("PG&E Br.") offers no persuasive reason for this Court to reach any different conclusion.

1. Actual and Ongoing Violation. PG&E barely defends the Bankruptcy Court's application of the "actual and ongoing violation" requirement of the *Young* doctrine. Instead, PG&E tries to recast a lawful prepetition action by the Commission (the adoption of the True-up), which the Commission did not take any postpetition action to enforce, into an actual and currently ongoing violation of federal law. The attempt does not succeed.

PG&E first claims that "if [the True-up's] implementation or enforcement would violate the automatic stay, [the True-up] necessarily violates federal law." (PG&E Br. at 19.) This is plainly wrong. In order to have availed itself of the *Young* doctrine, PG&E must have shown an actual and currently ongoing violation of law by the Commissioners *at the time PG&E filed its adversary proceeding*, not at some hypothetical future time. Whether "implementation or enforcement" of the True-up in the future, had it ever happened, might *then* have violated federal law does not mean that the Commission had violated federal law at the time PG&E filed its adversary proceeding. On that critical issue, PG&E has nothing to say.

PG&E next claims that a violation of federal law in the past is sufficient to trigger the actual and ongoing violation requirement. Even if this were true, it would not matter in this case because PG&E did not allege any violation of federal law by the Commissioners, either past or present. But PG&E is also wrong on the law. A past violation of federal law is not sufficient for purposes of the *Young* doctrine. (Comm. Br. at 16-18 & n.8; *infra* at 4-5.) The *Young* doctrine does not apply where "federal law has been violated at one time or over a period of time in the past." *United Mexican States v. Woods*, 126 F.3d 1220, 1223 (9th Cir. 1997).

Finally, PG&E suggests that the Commission violated federal law on an actual and ongoing basis merely because the True-up "imposed a duty on PG&E." (PG&E Br.

at 19-20.) PG&E is wrong. PG&E does not cite a single case, and the Commissioners are not aware of any, that found any "imposed" or "unenforced" duty on the plaintiff sufficient to establish an actual and ongoing violation by the defendant state officials. In all the cases, the only question is whether the state officials are engaging in conduct that allegedly violates federal law. Indeed, the cornerstone of the *Young* doctrine is the fiction that *unlawful conduct by state officials* is not conduct of the state, and therefore is not shielded by the state's sovereign immunity. Without any such unlawful conduct by state officials, there is no basis for application of *Young*, regardless of any "imposed" or "unenforced" duties on the plaintiff.

Here, PG&E did not allege any unlawful conduct by the Commissioners. PG&E alleged only that the automatic stay, once PG&E filed for bankruptcy, would have prevented certain hypothetical postpetition actions by the Commissioners to "implement or enforce" the True-up. PG&E's allegation that the automatic stay would have prevented certain postpetition actions to enforce the True-up did not make the True-up itself allegedly "illegal" in any sense. Similarly, any supposed "duty" that the True-up imposed upon PG&E did not make the True-up illegal or convert any lawful prepetition actions by the Commission into postpetition actions in violation of the automatic stay. In the end, PG&E merely contends that a lawful prepetition act by the Commission had continuing consequences for PG&E. The Supreme Court has held that *Young* does not apply in such circumstances. (*Infra* at 7.)

2. Waiver. PG&E contends, for the first time on appeal, that the Commission has waived its sovereign immunity. The Court should reject that argument:

First, presumably because most of the acts constituting the alleged waiver had not occurred at the time of the Bankruptcy Court's decision, PG&E did not contend before the Bankruptcy Court that the Commission had waived its sovereign immunity. This appellate Court should not consider any issues that were not considered by the Bankruptcy Court in the first instance. PG&E's proper remedy would have been to bring a motion before the Bankruptcy Court, under Rule 60(b) of the Federal Rules of Civil Procedure as incorporated by Federal Rule of Bankruptcy Procedure 9024, for example, respecting any claims that the Commission has waived its sovereign immunity. Second, there is no support in the record for any waiver by the

Commission. PG&E seeks instead to base its waiver argument on over 70 new documents that PG&E hopes to introduce by way of request for judicial notice. The Court should deny PG&E's request for judicial notice, because it would introduce disputed issues of fact that have not been developed nor considered by a trial court. Third, this Court should not undertake the highly fact-sensitive waiver inquiry without the benefit of consideration by the Bankruptcy Court in the first instance, and without the benefit of a full factual record, developed in the context of adversarial litigation before a trial court. And finally, PG&E's argument that the Commission waived its sovereign immunity is incorrect on the merits.

STATEMENT OF FACTS

PG&E claims that the Commission has been "all over the lot" on whether the Accounting True-up creates a "defense" to PG&E's Rate Case. (PG&E Br. at 16 n.16.) The Commission has maintained, from the beginning, that the question of what effect (if any) the True-up has on the Rate Case is a question to be decided in the Rate Case. PG&E acknowledges that the validity of the True-up is not an issue in this adversary proceeding. (PG&E Br. at 16).

ARGUMENT

THE ELEVENTH AMENDMENT BARS THIS PROCEEDING

PG&E claims that it brought this adversary proceeding to prevent the Commission from asserting a "defense" to the Rate Case. (PG&E Br. at 16.) If that is true, then this proceeding cannot proceed in light of the Eleventh Amendment. *See Booth v. Maryland*, 112 F.3d 139, 143 (4th Cir. 1997) ("[E]njoining a state from asserting a particular defense in some future federal action would be precisely the sort of inroad on state sovereignty that the Eleventh Amendment forbids."), *cert. denied*, 524 U.S. 905 (1998).

As the Commission pointed out in its opening brief, the Court need not determine whether the Commission or the Commissioners are entitled to assert sovereign immunity because PG&E's appeal can be easily disposed of on its merits. (Comm. Br. at 12-13.)

A. The Bankruptcy Court Incorrectly Determined that PG&E's Claims Against the Individual Commissioners Could Proceed Under the Doctrine of *Ex Parte Young*

1. PG&E Did Not Seek Prospective Relief to Remedy Any Alleged Actual and Ongoing Violation of Federal Law by the Commissioners

In its opening brief, the Commissioners showed that the Bankruptcy Court did not properly apply the "actual and ongoing violation of federal law" requirement of *Ex parte Young* and improperly permitted this action to proceed against the Commissioners. (Comm. Br. at 16-18.) Rather than defend the Bankruptcy Court's application of *Young*, PG&E tries to "reinvent" the adoption of the Accounting True-up—which PG&E acknowledges was a lawful prepetition action by the Commission—into an "actual" and currently "ongoing" violation of federal law. PG&E fails.

PG&E first claims that "if [the True-up's] implementation or enforcement would violate the automatic stay, [the True-up] necessarily violates federal law." (PG&E Br. at 19.) But that conclusion does not follow at all. PG&E's allegation that the automatic stay might have suspended enforcement of the True-up does not amount to an allegation that the True-up was itself "illegal" by reason of the automatic stay. After all, the fact that the automatic stay may operate to suspend a plaintiff's right to sue a bankrupt entity for breach of contract hardly means that underlying state contract law is "illegal" by reason of the stay. Furthermore, the *Young* doctrine is not predicated on any "illegality" of a law in the abstract, but on the specific conduct of state officials taken to enforce the law. Whether some hypothetical "implementation or enforcement" of the True-up by the Commission in the future might *then* have violated federal law says nothing about whether the Commission had violated federal law *at the time PG&E filed its adversary proceeding*.

PG&E next claims that the Eleventh Amendment "permits plaintiffs to bring an action to redress an ongoing and prospective violation of rights caused by defendants' pre-litigation conduct." (PG&E Br. at 20.) Although PG&E cannot bring itself to state the proposition openly, apparently PG&E is suggesting that a *past* violation of rights can suffice to establish a presently ongoing violation for purposes of the *Young* doctrine. First of all, in the

proceeding below PG&E did not allege even a past violation of rights by the Commissioners, so whether or not a past violation is sufficient is irrelevant. As explained, PG&E did not contend (and could not possibly have contended) that the prepetition True-up was unlawful under the automatic stay, which is effective only postpetition. (Comm. Br. at 18-19.) PG&E is also wrong on the law. A past violation of federal law is not a currently ongoing violation of law for purposes of *Young*. (Comm. Br. at 14.) In the words of the Ninth Circuit, the *Young* doctrine does not apply where "federal law has been violated at one time or over a period of time in the past." *United Mexican States v. Woods*, 126 F.3d 1220, 1223 (9th Cir. 1997); *accord Papasan v. Allain*, 478 U.S. 265, 277-78 (1986) ("*Young* has been focused on cases in which a violation of federal law by a state official is ongoing as opposed to cases in which federal law has been violated at one time or over a period of time in the past . . . .").

Finally, PG&E suggests that the Commissioners are violating federal law on an actual and ongoing basis merely because the True-up "imposed a duty on PG&E." (PG&E Br. at 19-20.) According to PG&E, a "pending but unenforced duty" imposed upon PG&E is sufficient to trigger *Young*. (PG&E Br. at 21.) But PG&E does not explain how any "duty" imposed upon PG&E would be inconsistent with automatic stay, which generally bars an "action or proceeding" against the debtor or an "act" to exercise control over the debtor's estate. (Comm. Br. at 34-43.) PG&E is wrong in any event. PG&E does not cite any authority, and there is none, that an "imposed" or "unenforced" duty on the plaintiff is sufficient to establish an actual and ongoing violation by the defendant state officials. The sole question is always whether the state officials are engaging in conduct that allegedly violates federal law. As the Commissioners have shown, the entire *Young* doctrine is predicated on the fiction that illegal acts by state officials are not actions of the State, and therefore not protected by the State's sovereign immunity. (Comm. Br. at 17-18.) In the absence of any such illegal conduct, the actions by the state officials are fully protected by sovereign immunity, and there is thus no basis to permit the officials to be sued in federal court. For this reason, any "duty" that may have been imposed on PG&E is completely irrelevant for purposes of *Young*. The critical inquiry is

whether the Commission had taken any actual conduct that amounted to an ongoing violation of federal law.

In the Bankruptcy Court, PG&E did not allege any such unlawful conduct. At most, PG&E alleged that the automatic stay, once PG&E filed for bankruptcy, would have prevented certain hypothetical postpetition actions by the Commissioners to "implement or enforce" the True-up. But just because the automatic stay might have prevented certain postpetition actions to enforce the True-up did not make the True-up "illegal" or convert any lawful prepetition actions by the Commission into postpetition actions in violation of the automatic stay. Similarly, just because the True-up imposed some "duty" upon PG&E did not make the True-up illegal or create a basis for finding that the Commission had engaged in a continuing violation of the automatic stay. As the Supreme Court has indicated, a litigant cannot come within *Young* by alleging merely (as PG&E does here) that a State official's act in the past has continuing consequences for the plaintiff. (*Infra* at 7, discussing *Papasan*.)

The two "well-established examples" that PG&E relies on have no application here. PG&E mentions *habeas* cases, which challenge a prison warden's continued confinement of a prisoner by reason of an allegedly unlawful conviction. (PG&E Br. at 20.) There, the alleged ongoing violation is the warden's affirmative and ongoing act of imprisoning a human being. Similarly, an employee discharged in violation of federal law (the other example relied upon by PG&E) can assert that the discharge "is a continuing violation [because] as long as the state official keeps him out of his allegedly tenured position the official acts in what is claimed to be derogation of [plaintiff's] constitutional rights." *Elliot v. Hinds*, 786 F.2d 298, 302 (7th Cir. 1986) (cited by PG&E at 20). Here, in contrast, PG&E did not allege, and could not have alleged, that the automatic stay imposed on the Commissioners any current parallel obligation to take some affirmative step, and that that the Commissioners' failure to take that affirmative step therefore constituted an ongoing violation of federal law.

The two cases that PG&E cites in a footnote (at 20 n.19) not only fail to support its theory, they show that PG&E did not allege any ongoing violation of federal law by the Commissioners here. In *Papasan*, plaintiffs asserted two claims against State officials. The first

claim rested on allegations that in the past, Mississippi officials had improvidently disposed of federal trust lands to be used to support public schools, and that as a result, schoolchildren had been deprived of adequate current school funding in violation of federal trust law. Plaintiffs sought an injunction requiring Mississippi officials to meet an alleged continuing obligation to provide adequate funding. The Supreme Court held that this claim was barred by the Eleventh Amendment and did not fit within the *Young* exception. The Court explained:

> We have . . . described certain types of cases that formally meet the *Young* requirements of a state official acting inconsistently with federal law but that stretch that case too far and would upset the balance of federal and state interests that it embodies. *Young*'s applicability has been tailored to conform as precisely as possible to those specific situations in which it is necessary to permit the federal courts to vindicate federal rights and hold state officials responsible to the supreme authority of the United States. Consequently, *Young* has been focused on cases in which a violation of federal law by a state official is ongoing as opposed to cases in which federal law has been violated at one time or over a period of time in the past, as well as on cases in which the relief against the state official directly ends the violation of federal law . . . .

Papasan, 478 U.S. at 277-78 (internal quotations and citations omitted).

Based on these principles, the Court held that the *Papasan* plaintiffs' first claim, although formally based on an alleged "continuing obligation on the part of the trustee" officials, was really an action alleging "ongoing liability for *past* breach of trust," and therefore fell outside *Young*. *Id.* at 280 (emphasis added).

Papasan thus demonstrates that a litigant cannot come within *Young* by alleging merely (as PG&E does here) that a State official's act in the past has continuing consequences for the plaintiff. What counts is whether the State official is actually committing a continuing violation of federal law. This is why PG&E's insistence that the True-up imposed current and future obligations on PG&E is, for purposes of *Young*, completely beside the point. PG&E brought no claim in this action that the Commissioners acted unlawfully when they promulgated the True-up, and PG&E did not coherently claim that the True-up "violated" federal law. PG&E claimed only that "implementation" or enforcement of the Order was stayed by federal law, and that claim cannot be cast as an accusation that the Commissioners were engaged in an ongoing violation of federal law.

Papasan sustained plaintiffs' second claim against Eleventh Amendment attack. In that claim, plaintiffs alleged that the defendant Mississippi officials were currently distributing the income from certain lands and trusts unequally among Mississippi school districts, to the detriment of schools in certain counties. This claim, the Supreme Court held, focused on "the present disparity in the distribution of the benefits of state-held assets, and *not* the past actions of the State." 478 U.S. at 282 (emphasis added). PG&E therefore misdescribes this claim when it asserts that the Court upheld a claim challenging disparate funding "due to State's sale of property held in trust years earlier." (PG&E Br. at 20 n.19.) Rather, the Court upheld the equal protection claim because it challenged current school funding decisions by State officials as an ongoing violation of federal law, and did not focus on the past sales of trust property.

PG&E also cites *Milliken v. Bradley*, 433 U.S. 267 (1977). *Milliken*, a school desegregation case, does not support PG&E's position any more than *Papasan* does. As a matter of substantive federal equal-protection law, if a school district has imposed legally mandated segregation by race, the school district has an affirmative, ongoing obligation to wipe out the vestiges of that discrimination. The Supreme Court held that *Young* therefore permitted a federal court to order Detroit school officials to take prospective measures to remedy their ongoing and continuing violation of their federal duty to desegregate:

> The decree requires state officials . . . to eliminate a de jure segregated school system. More precisely, the burden of state officials is that set forth in *Swann*—to take the necessary steps "to eliminate from the public schools all vestiges of state-imposed segregation." The educational components, which the District Court ordered into effect prospectively, are plainly designed to wipe out *continuing* conditions of inequality. . . .

Milliken, 433 U.S. at 289-90 (emphasis added, internal citations omitted).

Contrary to PG&E's suggestion, therefore, *Milliken* is not a case where a State official merely took some past action that then disadvantaged plaintiffs in the present. The State officials there were engaged, the Supreme Court held, in an ongoing violation of their substantive Constitutional duty to eliminate "*continuing* conditions of inequality."

2. The Bankruptcy Court Incorrectly Determined that There Was a Sufficient "Threat" that the Commissioners Would Take Action to Enforce the True-up

As the Commission has shown, the Bankruptcy Court improperly determined that this action could proceed under *Young* based upon some "threat" that the Commission would implement or enforce the True-up. (Comm. Br. at 20-21.) By that phrase, the Bankruptcy Court did not mean that the Commissioners had actually threatened in any way to take enforcement action arguably barred by the automatic stay. The Bankruptcy Court meant only that in the nature of things, the Commissioners could or might enforce the True-up. That is insufficient. *See* Comm. Br. at 20-21; *Children's Healthcare is a Legal Duty, Inc. v. Deters*, 92 F.3d 1412, 1415 (6th Cir. 1996) ("*Young* does not apply when a defendant state official has neither enforced nor threatened to enforce the allegedly unconstitutional state statute.") (citing voluminous authority); *Young*, 209 U.S. at 155-56 ("[O]fficers of the state . . . *who threaten and are about to commence proceedings* . . . may be enjoined by a federal court.") (emphasis added).

PG&E relies on three cases, none of which is applicable here. First, PG&E cites *Agua Caliente Band of Cahuilla Indians v. Hardin*, 223 F.3d 1041, 1045 (9th Cir. 2000), *cert. denied*, 121 S. Ct. 1485 (2001). The Commissioners distinguished that case in its opening brief. (Comm. Br. at 21 n.11 & n.12.) PG&E does not even attempt to explain in its appeal brief why the Commissioners' treatment of *Agua Caliente* is wrong. PG&E claims only that *Agua Caliente* suggests a "pending but unenforced duty" imposed upon PG&E is sufficient to trigger *Young*. But the case suggests nothing of the sort. As the Commissioners have explained, *Young* was triggered in *Agua Caliente* not by any "pending unenforced duty," but because the plaintiffs had alleged an actual and ongoing violation of federal law, in that state officials had issued tax assessments in alleged violation of federal law. Here, PG&E did not allege any similar unlawful actions.

The other authority cited by PG&E is equally wide of the mark. In *Waste Management Holdings, Inc. v. Gilmore*, 252 F.3d 316 (4th Cir. 2001), there was no issue raised concerning whether a "threat" of enforcement was sufficient under *Young*. And, in any event, the content of the state statute at issue was allegedly *itself* contrary to federal law, just as in *Agua*

Caliente, whereas here PG&E did not make, and could not make, any similar allegation against the content of the True-up.

The final case relied upon by PG&E is in *Summit Med. Assocs. v. Pryor*, 180 F.3d 1326 (11th Cir. 1999). That case is distinguishable on several grounds. First, in *Summit* the state officials had affirmatively expressed, in writing, their intent to enforce the statute against those violating it, and there was no question given the circumstances that the officials would carry through on that threat. *See id.* at 1339. The narrow issue in *Summit* was not whether a "threat" of enforcement was sufficient, because there clearly was such a threat, but whether *Young* required the state official to threaten to enforce the statute against the specific plaintiffs in the case. Here, the Commission did not express any intention to enforce the True-up. (Comm. Br. at 19 n.10 & at 21 n.12.) Second, in *Summit* the content of a state statute was itself allegedly contrary to federal law, as was true in *Agua Caliente* and *Waste Management*, but as is *not* true here. Third, the statutes at issue in *Summit* were criminal statutes, enacted in connection with abortion protests, which imposed severe penalties (up to ten years in jail) for a violation. *See id.* at 1339-40.

3. The *Young* Doctrine Does Not Apply Because the Relief Requested by PG&E Would Drastically Interfere with California's "Special Sovereignty Interest" in Using its Police Power to Manage the Statewide Energy Crisis

PG&E understates the relief that this proceeding seeks. As explained in the Commission's opening brief, the sweeping relief that PG&E seeks would upset the entire balance between competing interests that California has struck as a centerpiece of the statewide utility deregulation. (Comm. Br. at 22-24.) In a very real sense, PG&E is asking the Court to displace the State's central judgments on this deregulation in favor of PG&E's own. The affront to California's sovereignty is not just that the relief PG&E seeks "implicates" a core area of state sovereignty, the regulation of public utilities, but that the relief implicates that core area of sovereignty so intrusively that PG&E's action is effectively against California itself. Under these circumstances, the relief PG&E requests in this proceeding would infringe upon California's "special sovereign interest" in a way comparable to the infringement at issue in

Idaho v. Coeur D'Alene Tribe, 521 U.S. 261, 270 (1997). *See id.* at 281-283, 289, 296 (O'Connor, J., concurring) (*Young* inapplicable where "it simply cannot be said that the suit is not a suit against the state"); *Agua Caliente*, 223 F.3d at 1045-1048; *ANR Pipeline Co. v. LaFaver*, 150 F.3d 1178, 1194 (10th Cir. 1998).

B. The Court Should Reject PG&E's Argument, Raised for the First Time on Appeal And Unsupported in the Appellate Record, That the Commission Waived Its Sovereign Immunity in This Proceeding

PG&E contends that the Commission has waived its sovereign immunity. The Court should reject that argument for several independent reasons:

First, PG&E did not raise any waiver contention in the Bankruptcy Court. Most of the acts constituting the alleged waiver had not occurred at the time of the Bankruptcy Court's decision. As we show below, this appellate Court should not consider any issues that the Bankruptcy Court did not first consider. Second, there is no support in the record for any waiver by the Commission. Knowing this, PG&E seeks to base its waiver argument on over 70 new documents, totaling a thousand or so pages, that PG&E seeks to introduce by way of request for judicial notice. As we show below, PG&E's request for judicial notice should be denied. Third, this appellate Court should not undertake the highly fact-sensitive inquiry into whether the Commission waived its sovereign immunity without the benefit of consideration by the Bankruptcy Court, and without the benefit of a fully developed factual record. And finally, on the merits PG&E's argument that the Commission waived its sovereign immunity is incorrect.

1. The Court Should Not Consider PG&E's Waiver Argument Because It Was Raised For the First Time On Appeal

"As a general rule, a federal appellate court does not consider an issue not passed upon below." *United States v. Patrin*, 575 F.2d 708, 712 (9th Cir. 1978) (internal quotations omitted). Although there are exceptions to this rule, none is applicable here.[1] PG&E should

[1] An appellate court may consider an issue raised for the first time on appeal where the new issue "is purely one of law and either does not affect or rely upon the factual record developed by the parties or the pertinent record has been fully developed." *Id.* (citations omitted). As PG&E's newly raised waiver argument is highly fact-sensitive, and no factual record has been developed at all, that exception cannot apply. An appellate court, if the interests of justice so demand, also may consider a new issue where it "has first come to light

(continued on next page)

have brought a motion before the Bankruptcy Court respecting any claims it may have that the Commission has waived its sovereign immunity. PG&E does not dispute that its bankruptcy case is still pending, and, therefore the Bankruptcy Court still has jurisdiction to hear any claims to waiver.

2. PG&E's Request for Judicial Notice Should be Denied Because It Would Create New Disputed Issues of Fact That Should Not Be Resolved by this Appellate Court in the First Instance

The appellate courts generally deny requests for judicial notice that are designed to support issues or legal theories that were not raised in the court below. *See First Am. Title Ins. Co. v. Naegele*, 35 F.2d 1072 at **3 (9th Cir. 1994) (unpublished opinion).

Here, PG&E has brought just the sort of request for judicial notice that appellate courts will deny: a request to introduce facts to support a new legal theory that was not considered by the court below, and otherwise has absolutely no support in the record on appeal. *See id.*; *Nantucket Investors II v. Cal. Fed. Bank (In re Indian Palms Assocs., Ltd.)*, 61 F.3d 197, 205 (3d Cir. 1995) (appellate court should not take judicial notice where "unfair to a party to do so" and would "undermine the trial court's factfinding authority"); *Kemlon Prods. & Dev. Co. v. United States*, 646 F.2d 223, 224 (5th Cir. 1981).

In addition, a court should take judicial notice only of facts which are "not subject to reasonable dispute." Fed. R. Evid. 201(b); *see Nantucket*, 61 F.3d at 205. Here, while perhaps the fact that a certain proof of claim was filed might not be subject to dispute, the waiver inquiry requires consideration of facts and circumstances beyond just the face of the proof of claim. As we show immediately below, the critical inquiry is whether the "aggregate set of operative facts" of the proof of claim is the same set of aggregate facts of PG&E's claims in this proceeding. The Commission disputes that these aggregate facts are the same, and would be entitled to develop and submit its own evidence to support that contention. The practical effect

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during the pendency of the appeal *because of a recent change in the law . . .*" *Id.* (emphasis added). PG&E does not claim that there has been any "recent change in the law." Although PG&E claims that there have been some new factual developments, the exception does not cover new factual developments.

of granting PG&E's request for judicial notice, therefore, would be to invite a dispute over contested facts that the parties have not had any opportunity to develop, and that the Bankruptcy Court has not considered in the first instance. The function of an appellate court is not as a trier of fact, let alone a trier of facts that are not part of the record on appeal and have not been developed by the parties.

3. This Appellate Court Should Refrain From Undertaking in the First Instance the Highly Fact-Sensitive Inquiry Into Whether the Commission Waived Its Sovereign Immunity

PG&E has identified a number of purported proofs of claim filed by state agencies, only one of which was filed by the Commission. These proofs of claim have nothing to do with PG&E's claims against the Commission in the proceeding below, namely "implementation or enforcement" of the True-up. PG&E suggests that because these claims have been filed, the Commission has waived its sovereign immunity against any claim that PG&E might bring. But filing a proof of claim will not "waive" sovereign immunity with respect to any claim that the debtor might assert against the state. To the contrary, "when a state files a proof of claim against a debtor, it waives its Eleventh Amendment immunity with respect to the adjudication of *that* claim." *Lazar v. California (In re Lazar)*, 237 F.3d 967, 977 (9th Cir. 2001) (emphasis added). Moreover, a proof of claim filed by one state agency does not automatically "waive" the sovereign immunity of another state agency. *See id.* at 979 n.13.

The inquiry into whether a state agency has "waived" its sovereign immunity is highly fact-sensitive. As the Ninth Circuit has held, when a state files a proof of claim in a bankruptcy, "the state waives its Eleventh Amendment immunity with regard to the bankruptcy estate's claims that arise from the same transaction or occurrence as the state's claim." *Id.* at 979. In order to determine whether a claim arises from the same "transaction or occurrence," the Court must apply the highly fact-sensitive "logical relationship" test:

> A logical relationship exists when the [plaintiff's claim] arises from the same aggregate set of operative facts as the initial [proof of] claim, in that the same operative facts serve as the basis of both claims or the aggregate core of facts upon which the claim rests activates additional legal rights otherwise dormant in the defendant.

Id. (citations omitted).

The "logical relationship" test does not even end there. Since PG&E is arguing that the Commission has "waived" its sovereign immunity primarily because *other state agencies* have filed proofs of claim, the Court must also consider the relevant state laws concerning which state agencies are authorized to submit which proofs of claim. *See id.* at 978 n.11, 979 n.13.

Here, PG&E has not provided any information that would assist the Court in applying the "logical relationship" test to determine whether the proofs of claim it has identified arise out of the same "transaction or occurrence" as PG&E's claims against the Commission in this proceeding. PG&E has simply listed a number of proofs of claim that state agencies have purportedly filed, without anything more than vague descriptions of what those proofs of claim are for. The proofs of claim on their face describe what they seek in only the most general terms. PG&E has not provided any information on the state laws concerning which agencies may file which proofs of claim. Apparently, PG&E leaves it to the Court to perform, all by itself, the enormous task of reading through a thousand pages of proofs of claim, and researching the state law on filing proofs of claim, to determine whether any of the more than 70 claims submitted by more than 20 state agencies "arise[ ] from the same aggregate set of operative facts" as PG&E's claims against the Commission in this proceeding. The Commission respectfully submits that this fact-sensitive inquiry should not be entertained for the first time on appeal, without the benefit of consideration by the Bankruptcy Court in the first instance, and especially because there is no factual record concerning these proofs of claim.

4. Even on the Merits, the Commission Did Not "Waive" Its Sovereign Immunity <u>In Connection With the Claims Asserted By PG&E In This Proceeding</u>

In any event, PG&E's waiver claim has no merit. In the Ninth Circuit, "the test for determining whether a State has waived its sovereign immunity is a stringent one." *In re Mitchell*, 209 F.3d 1111, 1117 (9th Cir. 2000) (quotations omitted). A state "must unequivocally express its consent to federal jurisdiction." *Id.* (quotations omitted). "The state's consent . . . is effective only where stated by the most express language." *Yakima Indian Nation v. Wash. Dep't of Revenue*, 176 F.3d 1241, 1245 (9th Cir. 1999). Under this "stringent" standard, the actions by the Commission in the bankruptcy case, which were primarily directed at *asserting* its

sovereign immunity, cannot possibly amount to the "unequivocal" expression of consent that is required for a waiver. PG&E's contention to the contrary is further belied by the Commission's Proof of Claim, which states unequivocally that its filing shall not be deemed or construed as a waiver of, among other things, the Commission's rights under the Eleventh Amendment or related principles of sovereign immunity.

(a) The Commission Has Not "Waived" Its Sovereign Immunity Through the Filing of any Proofs of Claim

As explained above, the state "waives" its Eleventh Amendment immunity *only* with regard to the debtor's claims "that arise from the same transaction or occurrence as the state's claim." *Lazar*, 237 F.3d at 979.

The proofs of claim that PG&E has identified will not meet this test. They clearly have nothing to do with the claim that PG&E asserts in this proceeding, against implementation or enforcement of the True-up. *See* RJN Ex. 18 (permits and certifications); RJN Ex. 22 (clean-up and closure costs for hazardous waste facility); RJN Ex. 25 (loan for improvements to certain facilities); RJN Exs. 26, 40, 72 (corporate taxes); RJN Ex. 27 (unpaid taxes); RJN Exs. 28-38 (utility relocation costs); RJN Ex. 39 (costs for prison installation); RJN Exs. 41-43 (lease easements); RJN Exs. 44-54 (costs incurred in fighting fires); (RJN Exs. 58-60 (remediation costs at certain sites); RJN Exs. 61, 64-66 (fees for two timber harvest plants, costs for fish stocking program, and sea water monitoring services); RJN Ex. 62 (remediation costs at nuclear plant); RJN Ex. 63 (fees for commercial coaches); RJN Exs. 67-71 (environmental clean-up costs); RJN Ex.73 (clean-up costs). The only claims that are even conceivably connected, however vaguely, to implementation or enforcement of the True-up are those few claims filed in connection with the general electricity crisis. But even those proofs of claim hardly arise from the same "transaction or occurrence" as implementation or enforcement of the True-up, unless the Court were to stretch the test beyond recognition to include anything connected in some general way to California's power crisis.

In addition, virtually all of the state agencies that filed the proofs of claim clearly have nothing to do with PG&E's assault on the Commission's regulatory authority at issue in

this proceeding. *See* RJN Ex. 18 (Department of Justice); RJN Exs. 26, 40, 72 (Franchise Tax Board); RJN Ex. 27 (Board of Equalization); RJN Exs. 28-38 (Department of Transportation); RJN Ex. 39 (Department of Corrections); RJN Exs. 41-43 (Department of General Services); RJN Exs. 44-54 (Department of Forestry and Fire Protection); RJN Ex. 57 (Regents of the University of California); RJN Exs. 58-60 (Department of Toxic Substances Control); RJN Exs. 61, 64-66 (Department of Fish and Game); RJN Ex. 63 (Department of Housing and Community Development); RJN Exs. 67-71 (Water Quality Control Boards); RJN Ex. 73 (Water Resources Control Board).

As for the lone proof of claim submitted by the Commission, it does not have anything to do with "implementation or enforcement" of the True-up. *See* RJN Ex. 56 (claims in respect of California Environmental Quality Act, user fees, Women/Minority/Disabled/Veteran Business Enterprise Programs and miscellaneous items).

(b) The Commission Has Not Waived Its Sovereign Immunity Through Any "Participation" in PG&E's Bankruptcy Case

PG&E also claims that the Commission has waived its sovereign immunity because state agencies have "participated" in the main bankruptcy case. (PG&E Br. at 41.) This claim is without merit. In order to present its argument, PG&E again relies on stacks of materials that are not part of the record on appeal, and which PG&E seeks to introduce by judicial notice. As explained above, that request should be denied, and the Court should refrain from considering the waiver argument in the first instance.

Even taking those materials on face value, PG&E's claim to "participation" is rhetoric at best. According to PG&E, state agencies have "flex[ed] their regulatory muscle" (PG&E Br. at 41), "assert[ed] their regulatory authority over PG&E" (at 42), "attended a deposition" (at 42), and "become one of the most active critics of PG&E's Reorganization Plan." (PG&E Br. at 42.) What PG&E does not claim, however, is that the Commission has "participated" *in this adversary proceeding*, other than to resist PG&E's efforts to strip the Commission of its sovereign regulatory authority, and to assert its sovereign immunity.

PG&E recognizes, as it must, that the Commission has asserted its Eleventh Amendment immunity in the Bankruptcy Court at every step. (PG&E Br. at 47.) This is completely inconsistent with PG&E's contention that the Commission has "unequivocally express[ed] its consent to federal jurisdiction." *Mitchell*, 209 F.2d at 1117.

PG&E relies heavily on *Hill v. Blind Indus. & Servs. of Maryland*, 179 F.3d 754 (9th Cir. 1999). That case is distinguishable. First, the state agency in *Hill* participated in extensive pre-trial activities and discovery in the same action that the plaintiff had brought against it, right up until the eve of trial, and therefore subjected itself to jurisdiction over the claims in that case. Here, by stark contrast, the Commission has done nothing in this proceeding other than to move to dismiss the action on the grounds of sovereign immunity, among other grounds. Second, the state agency in *Hill* deliberately waited until the eve of trial to assert its sovereign immunity, in order to improperly "hedge its bet" on the outcome of the trial. *See Hill*, 179 F.3d at 757-57. Here by contrast, and like the state agency found to have retained its sovereign immunity in *Mitchell*, the Commission "immediately asserted its immunity" to the claims brought by PG&E. *See Michell*, 209 F.2d at 1118 (distinguishing *Hill* on this basis).

PG&E also relies on *Pitts v. Ohio Department of Taxation (In re Pitts)*, 241 B.R. 862 (Bankr. N.D. Ohio 1999). That case, however, refutes rather than supports PG&E's waiver contention. In *Pitts*, the court held that the state agency had *not* waived its sovereign immunity in an adversary proceeding brought against the agency because, like the agency in *Mitchell*, the agency "immediately raised" its sovereign immunity in that proceeding. *See id.* at 878.

The other cases relied upon by PG&E are equally wide of the mark. Although PG&E suggests these cases found a wholesale waiver based upon some general "participation" in a bankruptcy, the cases involve extensive, affirmative efforts by a state agency to collect on a specific debt, or otherwise to further specific pecuniary interests the agency had in the debtors' estate, in a proceeding that the agency then claims cannot bind it because of sovereign

immunity.[2] In these cases, the state agency was not acting as a regulator, as the Commission is here, but as a *creditor* of the estate seeking to collect on a debt or other pecuniary interest in property of the estate. These cases, therefore, merely stand for the general rule, discussed above, that when a state agency files a proof of claim in a bankruptcy, it "waives" its sovereign immunity with respect to adjudication of only *that* claim. Here, PG&E can point to no affirmative actions by the Commission to present any debts or claims concerning the True-up for adjudication by the Bankruptcy Court. To the contrary, the Commission has asserted from the beginning that the entire adversary proceeding cannot proceed on the grounds of sovereign immunity.

What is more, the cases cited by PG&E involve only *limited* waivers of sovereign immunity in connection with the specific debt or proof of claim asserted, and not the wholesale waiver of sovereign immunity on all aspects of PG&E's case that PG&E seeks here.[3]

PG&E suggests that the Commission has "invoked the court's jurisdiction in order to assert its regulatory interests in PG&E." (PG&E Br. at 46.) Not only is that suggestion misleading as a matter of fact, the suggestion is legally irrelevant. On the facts, neither the Commission nor any other state agency has "invoked" the jurisdiction of the Bankruptcy Court to assert any regulatory interests. Rather, it was *PG&E* that sought to use the bankruptcy laws to

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[2] *First Union Nat'l Bank v. MCA Fin. Corp. (In re MCA Fin. Corp.)*, 237 B.R. 338, 341-42 (Bankr. E.D. Mich. 1999) (state agency attempted to collect debtor's physical property and affirmatively sought adjudication in federal court that it had the right to collect the property); *Hankins v. Finnel*, 964 F.2d 853, 858 (8th Cir. 1992) (state represented defendant at all stages of the litigation, agreed to indemnify him, and then tried to use its sovereign immunity to "renege" on its promise to indemnify); *Confederated Tribes v. White (In re White)*, 139 F.3d 1268, 1270-71 (9th Cir. 1998) (tribe affirmatively sought to collect on a debt by filing the practical equivalent of a proof of claim); *Commonwealth of Va. Dep't of Med. Ass't Servs. v. Shenandoah Realty Partners, L.P. (In re Shenandoah Realty Partners, L.P.)*, 248 B.R. 505, 512 (W.D. Va. 2000) (state filed proof of claim and actively litigated that proof of claim, including extensive discovery and motion practice).

[3] *See First Union*, 237 B.R. at 342 (state waived sovereign immunity only with respect to "respective rights and interests in that property" the state attempted to collect from estate); *Hankins*, 964 F.2d at 858 ("the district court found a waiver only with respect to the narrow facts of this case"); *Confederated Tribes*, 139 F.3d at 1270-71 (waiver limited solely to adjudication of tribe's request to collect on a debt); *Shenandoah*, 248 B.R. at 512 (state waived sovereign immunity only with respect to right to collect on proof of claim it had submitted in the bankruptcy).

divest the Commission of its sovereign regulatory authority. That the Commission resisted PG&E's attempt by asserting its sovereign immunity as a state regulator, and by asserting that the Bankruptcy Court has no jurisdiction to permit PG&E to divest the Commission of regulatory authority, is hardly an unequivocal indication of "invoking" the Bankruptcy Court's jurisdiction. If anything, the Commission has done exactly the opposite, and fought at every step efforts by PG&E to manipulate the Bankruptcy Court proceedings in order to oust the Commission of its regulatory jurisdiction. If PG&E were correct that the Commission has waived its sovereign immunity by asserting its sovereign immunity, then the concept of sovereign immunity would be meaningless.

The suggestion is also legally irrelevant. Although PG&E bases its contention on cases involving a state agency asserting a claim to property of the debtor's estate, as a creditor would, there is a fundamental difference between a state attempting to collect property from the debtor and a state attempting to retain its regulatory authority over a debtor. Bankruptcy law is primarily concerned with the rights of debtors and creditors to a "res" (the debtor's estate) subject to the bankruptcy court's jurisdiction. When a state seeks to collect money or property from the debtor, the state assumes the role of creditor, and the courts have thus held that the state is not insulated from the bankruptcy court's jurisdiction over that property:

> [H]e who invokes the aid of the bankruptcy court by offering a proof of claim and demanding its allowance must abide by the consequences of that procedure. If the claimant is a State, the procedure of proof and allowance is not transmitted into a suit against the State because the court entertains objections to the claim. The State is seeking something from the debtor. No judgment is sought against the State. *The whole process of proof, allowance, and distribution is, shortly speaking, an adjudication of interests claimed in a res.* It is none the less such because the claim is rejected in toto, reduced in part, given a priority inferior to that claimed, or satisfied in some way other than payment in cash.

Gardner v. New Jersey, 329 U.S. 565, 573-74 (1947) (emphasis added).

In such circumstances, a bankruptcy court's jurisdiction flows from its jurisdiction over the property of the estate in question, not from any jurisdiction over the state itself. But when a state seeks to retain its regulatory authority over a debtor, the state is acting in its public capacity as a sovereign. The state is not claiming against property of the estate, and thus there is no basis for the bankruptcy court to assert jurisdiction over the state. The state

retains its sovereign rights, and to permit a debtor to push aside those rights would be a gross affront to the state's sovereignty. *See Seminole Tribe of Florida v. Florida*, 517 U.S. 44, 58 (1996) (Eleventh Amendment immunity "serves to avoid the indignity of subjecting a State to the coercive process of judicial tribunals at the insistence of private parties.").

CONCLUSION

For the foregoing reasons, the Commission and the Commissioners respectfully submit that PG&E's claims against the Commission and the Commissioners are barred in their entirety by the Eleventh Amendment and related principles of sovereign immunity.

Dated: December 26, 2001

Respectfully,

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UNITED STATES DISTRICT 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. 01-2490 VRW (Bankruptcy Case No. 01-30923 DM; Adv. Proceeding No. 01-3072 DM) Chapter 11 Case **PROOF OF SERVICE**
PACIFIC GAS AND ELECTRIC COMPANY, a California corporation. Plaintiff, Appellant and Cross-Appellee, - against - CALIFORNIA PUBLIC UTILITIES COMMISSION, and LORETTA M. LYNCH, HENRY M. DUQUE, RICHARD A. BILAS, CARL W. WOOD, and GEOFFREY F. BROWN, in their official capacities as Commissioners of the California Public Utilities Commission, Defendants, Appellees and Cross-Appellants.	

PROOF OF SERVICE

I, MARTHA PEREZ, declare:

1. I am not a party to this action, am over 18 years of age, and am employed by the California Public Utilities Commission, 505 Van Ness Avenue, San Francisco, California 94102.

2. On December 26, 2001, I caused to be served via electronic mail and hand delivery copies of **Cross-Appellants' Reply Brief And Opposition To Supplemental Request For Judicial Notice By Appellant And Cross-Appellee Pacific Gas And Electric Company** on the following:

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3. On December 26, 2001, I also caused to be served via electronic and overnight mail copies of the above-referenced court pleadings on the following:

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4. Finally, on December 26, 2001, I also caused to be served via overnight mail copies of the above-referenced court pleadings on the following:

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I declare under penalty of perjury that the foregoing is true and correct.

Executed on December 26, 2001, at San Francisco, California.

Martha Perez

0268

EXHIBIT C

COM/LYN/epg

Mailed 1/19/2001

Decision 01-01-046 January 19, 2001

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of Southern California Edison Company (E 3338-E) for Authority to Institute a Rate Stabilization Plan with a Rate Increase and End of Rate Freeze Tariffs.	Application 00-11-038 (Filed November 16, 2000)
Emergency Application of Pacific Gas and Electric Company to Adopt a Rate Stabilization Plan. (U 39 E)	Application 00-11-056 (Filed November 22, 2000)
Petition of THE UTILITY REFORM NETWORK for Modification of Resolution E-3527.	Application 00-10-028 (Filed October 17, 2000)

INTERIM OPINION AFFIRMING THE OBLIGATION TO SERVE AND ISSUING TEMPORARY RESTRAINING ORDER

I. Summary

In this interim decision, we are issuing a temporary restraining order (TRO) preventing Pacific Gas and Electric Company (PG&E) and Southern California Edison Company (Edison) from refusing to provide adequate service to all of their customers. We issue this TRO to maintain the status quo so as to avoid further degradation of provision of electric service and to avoid the irreparable harm to the public health and safety that would be caused by further degradation of service. We affirm that regulated California utilities must serve their customers. This requirement, known as the "obligation to serve" is

mandated by state law. A utility's obligation to serve is part and parcel of the entire regulatory scheme under which the Commission regulates and controls utilities under the Public Utilities Act.

A bankruptcy filing or the threat of insolvency has no bearing on this aspect of state law. Even utilities that file for reorganization must serve their customers. The public's safety, and the economy's health will be impaired if utilities avoid their obligation to serve. We will take all action necessary to enforce this obligation, while regulating and controlling utilities in a manner consistent with state law, and make the following orders:

II. Background

In Decision (D.) 01-01-018, we adopted an immediate, interim surcharge for PG&E and SCE, subject to refund and adjustment.[1] This surcharge is in effect for 90 days from the effective date of D.01-01-018. As stated in that decision, the increase is a temporary surcharge to improve the ability of the applicants to cover the costs of procuring future energy in wholesale markets that they cannot produce themselves to serve their loads. We determined that this expedited action was necessary to fulfill our statutory obligations to ensure that the utilities can provide adequate service at just and reasonable rates. Emergency hearings were held in late December 2000 and additional hearings are planned for February.

In D.01-01-018, we state that we do not yet have the facts to evaluate the utilities' claims of their dire circumstances. We have called for an audit and must await the independent auditors' report. Moreover, we do not have all of the facts

[1] Those customers eligible for the California Alternative Rates for Energy (CARE) program are exempt from this surcharge. The surcharge applies to all other customers, including direct access customers.

related to the parent companies, the utilities, the affiliates, and the flow of funds among these entities. The independent auditors will also consider these questions in their reports. We must consider the overall financial position of the utilities and will do so expeditiously.

Further, in D.01-01-018 we state:

> We are very troubled by the utilities' assumption that ratepayers must bear the burden of significant rate increases without the shareholders sharing in the pain. The utilities and their shareholders have received significant financial benefit from restructuring thus far. For example, PG&E and Edison have each received the benefit of over $2 billion in cash proceeds from rate reduction bonds. As reported in the monthly TCBA reports, PG&E has received over $9 billion in headroom and other transition cost revenues and Edison has received over $7 billion in such revenues. As revealed in cross-examination of PG&E witness Campbell, disbursements from PG&E to the parent company, PG&E Corporation (PG&E Corp.) during the transition period were approximately $9.6 billion. Out of this total, PG&E Corp. issued dividends (both common and preferred stock) of approximately $1.5 billion. PG&E also repurchased stock in the amount of approximately $2.8 billion and retired approximately $2.8 billion of debt. PG&E recognized that market problems were beginning to occur in June of this year, but decided to declare a third-quarter dividend. PG&E did not consider establishing a contingency fund or retaining cash to cushion its risk, because it believed that "its generally conservative financial profile and financing practices would adequately provide cushion against . . . a reasonable range of contingencies." (TR: 409.)
>
> Now that such contingencies are outside the reasonable range, the utilities turn to the ratepayers for relief. It is decidedly not business as usual and the utilities need to realize that ratepayers are not the only answer to their dilemma. For example, parties have only just begun to explore the ability of the utilities' holding companies to participate in the solution. While the cash on hand in the holding companies may be insufficient when compared with the going-

forward costs of procuring power, we are convinced that other potential solutions should be explored. (*Id.* mimeo. at pp. 15-16.)

III. Discussion

Since mid-June, we have seen prices in the wholesale electricity market skyrocket to staggering levels as a result of the severe dysfunction of the California wholesale electricity market. As a result, several deleterious consequences have occurred. Ratepayers in San Diego Gas & Electric Company's (SDG&E) service territory saw their electric bills double and triple over the summer. PG&E and Edison have defaulted on payments. Stage 1, 2, and 3 emergencies have occurred with alarming regularity, and indeed, rolling blackouts occurred in Northern California on January 17 and 18, 2001. The Governor, Legislature, and this agency are actively seeking solutions to the energy crisis confronting us. The Federal Energy Regulatory Commission (FERC), despite finding that wholesale electric rates are not just and reasonable, chose to lift price caps, and to refrain from devising a remedy under Section 206(a) of the Federal Power Act (16 USC Section 824e(a)),[2] while making a number of other changes that add to the complexity and uncertainty of the commercial relationships. As we explained in D.01-01-018, these actions have

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[2] This statute provides in pertinent part:

Whenever the Commission, after a hearing had upon its own motion or upon complaint, shall find that any rate, charge, or classification, demanded, observed, charged, or collected by any public utility for any transmission or sale subject to the jurisdiction of the Commission, or that any rule, regulation, practice, or contract affecting such rate, charge, or classification is unjust, unreasonable, unduly discriminatory or preferential, the Commission shall determine the just and reasonable rate, charge, classification, rule, regulation, practice, or contract to be thereafter observed and in force, and shall fix the same by order.

left California's utilities and ratepayers prey to wholesale electricity sellers who immediately quadrupled and quintupled their prices above already unprecedented levels.

In the hearings we held on financial issues in December and early January, a representative of Edison indicated that in the event that Edison could not purchase power in excess of the 7 cents per kilowatt-hour available in retail revenues to pay for power, Edison would request to be relieved of its obligation to serve. (TR: 755)

On January 18, we received a declaration from Gary Heath, Executive Director of the Electricity Oversight Board (EOB) regarding PG&E's assertion to the Deputy Director Raymond Hart of the California Department of Water Resources (CDWR). Mr. Hart informed Mr. Heath that PG&E stated that beginning January 20, 2001, PG&E would schedule only its own generation and would not purchase additional needed generation to serve remaining customer load. Mr. Heath verified this assertion with PG&E Vice President Dan Richard at 2:15 p.m. on January 18. Mr. Richard confirmed that PG&E would only serve its customers through its own generation, and therefore would not schedule the resources secured by the CDWR for PG&E's remaining load. Mr. Heath states that PG&E cannot rely on its own generation to meet its obligations to serve all the customers in its service territory. If PG&E does not obtain additional generation, reliability of service to PG&E customers will be "seriously jeopardized." (Declaration of Gary Heath, Attachment 1.)

Also on January 18, we received affidavits from Terry Winter, the President and Chief Executive of the California Independent System Operator (ISO) and Ziad Alaywan, Managing Director of the ISO. Mr. Winter declares that Harold Ray, a senior vice president of Edison, stated in a 4:15 p.m. telephone call that Edison plans to continue to act a scheduling coordinator for all of Edison's

non-direct access customers. Mr. Ray stated that there is not an intent to abandon any of its customers. At 4:20 p.m., Mr. Winter had a telephone conversation with Mr. Richard of PG&E and Bruce Worthington, General Counsel of PG&E. Mr. Richard stated that PG&E would not change its scheduling responsibilities at this time and that there was a misunderstanding of the scheduling coordination responsibilities regarding the CDWR's role as a conduit to serve some of PG&E's customers. Mr. Winter then declares that: "Mr. Richards [sic] advised me that while the company does not intend to change its scheduling coordination role for all its non-direct access customers at this time, the company will continue to review its scheduling coordination responsibilities to its non-direct access customers as the situation unfolds." (Affidavit of Terry Winter, Attachment 2.)

Mr. Alaywan declares that he participated in two conference calls with personnel from PG&E, Edison, and CDWR, which took place at approximately 8:00 a.m. and 2:00 p.m. on January 18, 2001. During the morning call, all participants agreed that PG&E and Edison would continue to act as scheduling coordinators for all their non-direct access customers, even though some customers would be served by generation provided by CDWR. PG&E and Edison agreed to undertake an inter-scheduling coordinator trade with CDWR in accordance with prescribed ISO processes. During the afternoon call, a PG&E director indicated that it no longer wished to act a scheduling coordinator for non-direct access customers served by generation provided by CDWR. The PG&E director stated that "PG&E does not wish to shirk its responsibilities, but stated again that another entity should serve as scheduling coordinator for customers served by CDWR generation." (Affidavit of Ziad Alaywan, Attachment 3.)

We also received a declaration, dated January 18, 2001, from Peter Garris, employed by the CDWR as Chief Water and Power Dispatcher. Mr. Garris confirms the 2:00 p.m. January 18 conference call described by Mr. Alaywan. Mr. Garris specifically states that Claudia Grief, Director of PG&E Scheduling, informed the participants that PG&E would not be the scheduling coordinator for load that could not be served by its own resources. Mr. Garris also participated in a 4:45 p.m. conference call with Ms. Grief, PG&E Vice President Roy Kuga, other CDWR staff, and individuals from the ISO and Power Exchange. Mr. Garris confirms that during this call, Mr. Kuga indicated that PG&E would not take scheduling coordinator trades from CDWR after Saturday, January 20, 2001, for energy acquired by CDWR for PG&E's load that is not served by PG&E's own generation. Mr. Garris states that PG&E lacks sufficient resources to meet its native load without securing energy from other sources; if this is left unresolved, PG&E's customers will experience adverse reliability problems.

IV. Obligation to Serve

State law clearly requires utilities to serve their customers, and a threatened bankruptcy filing or threat of insolvency does not change that obligation. Similarly, the financial distress of one utility cannot be used as an excuse by another utility to avoid its obligation to serve. As we stated in D.01-01-018, we have a duty to assure that the utilities are able to continue to procure and deliver power for their customers. This duty applies even if the utilities under our jurisdiction have filed for bankruptcy or are on the brink of petitioning for such relief. Our basic obligation under the Public Utilities Act is

to assure the people of California adequate service at reasonable rates. Section 451[3] provides, in relevant part:

> All charges demanded or received by any public utility, or by any two or more public utilities, for any product or commodity furnished or to be furnished or any service rendered or to be rendered shall be just and reasonable. Every unjust or unreasonable charge demanded or received for such product or commodity or service is unlawful. Every public utility shall furnish and maintain such adequate, efficient, just and reasonable service, instrumentalities, equipment and facilities as are necessary to promote the safety, health, comfort and convenience of its patrons, employees, and the public.

We therefore issue this decision to affirm that PG&E and Edison must continue to provide reliable, safe, and adequate service to all Californians at just and reasonable rates, including continuing to enter into and maintain any current and future low-cost contracts to procure power. Our actions are consistent with the Legislature's intent, as stated in §§ 330(g), 330(h) and 391(a), part of Assembly Bill (AB) 1890 (Stats. 1996, Ch. 854), which provide in relevant part:

> 330(g): Reliable electric service of utmost importance to the safety, health, and welfare of the state's citizenry and economy.
>
> 330(h): It is important that sufficient supplies of electric generation will be available to maintain the reliable service to the citizens and business of the state.
>
> 391(a): Electricity is essential to the health, safety, and economic well-being of all California consumers.

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[3] All statutory references are to the Public Utilities Code, unless otherwise noted.

In addition, §§ 761-788 give the Commission broad authority to issue orders controlling the equipment, practices and facilities of regulated utilities. For example, § 761 gives the Commission authority to order the "service, or methods to be observed, [or] furnished" by California Utilities. Section 761 also provides that utilities must furnish their commodities, or render their services according to the rules and orders of the Commission, so long as a customer makes "proper demand and tender of rates."

In relevant part, § 762 requires that:

> Whenever the commission, after a hearing, finds that additions, extensions, repairs, or improvements to, or changes in, the existing plant, equipment, apparatus, facilities, or other physical property of any public utility or of any two or more public utilities ought reasonably to be made, or that new structures should be erected, to promote the security or convenience of its employees or the public, or in any other way to secure adequate service or facilities, the commission shall make and serve an order directing that such additions, extensions, repairs, improvements, or changes be made or such structures be erected in the manner and within the time specified in the order.

Furthermore, § 768 provides, in relevant part:

> The commission may, after a hearing, require every public utility to construct, maintain, and operate its line, plant, system, equipment, apparatus, tracks, and premises in a manner so as to promote and safeguard the health and safety of its employees, passengers, customers, and the public.

Section 770 provides, in relevant part:

> The commission may, after a hearing:
>
> Ascertain and fix just and reasonable standards, classifications, regulations, practices, measurements, or service to be furnished, imposed, observed, and followed by all electrical, gas, water, and heat corporations.

Section 701 gives the Commission power to undertake all necessary actions to properly regulate and supervise California utilities. In Consumers Lobby Against Monopolies v. Public Utilities Commission (1979) 25 Cal.3d 891, 905, the California Supreme Court declared:

> The commission is a state agency of constitutional origin with far-reaching duties, functions and powers. (Cal. Const., Art. XII §§ 1-6.) The Constitution confers broad authority on the commission to regulate utilities, including the power to fix rtes, establish rules, hold various types of hearings, award reparation, and establish its own procedures (*Id.*, §§ 2, 4, 6.) ...
>
> Pursuant to this grant of power, the Legislature enacted Public Utilities Code section 701, conferring on the commission expansive authority to '*do all things*, whether specifically designated in [the Public Utilities Act] *or addition thereto*, which are necessary and convenient' in the supervision and regulation of every public utility in California. (Italics added.) the commission's authority has been liberally construed. (Consumers Lobby Against Monopolies at 905.)

The California Supreme Court has further found that "the commission often exercises equitable jurisdiction as an incident to its express duties and authority. For example, the commission may issue injunctions in aid of jurisdiction specifically conferred upon it." (*Id.* at 907.)

Therefore, under our plenary powers and until this crisis is resolved, we intend to closely monitor and supervise the actions and expenditures of the investor-owned utilities under our regulation to ensure that service is provided. While we are dismayed that the energy crisis has escalated to the point that such tight control by the State is required, we intend to exercise the required control. We recognize that hearings are required and will provide for these, as we discuss below. Today we issue a temporary restraining order in order to avoid irreparable harm to public health and safety, to maintain the status quo, and to ensure that PG&E and Edison continue to schedule generation through the ISO

to serve all customers with adequate, reliable service, consistent with their obligation to serve.

A TRO serves the purpose of preventing the actions of a party from causing irreparable harm to another party, pending a hearing on the need for a preliminary injunction. We are issuing this TRO on our motion and on an ex parte basis because we are convinced that if adequate service were not maintained, great or irreparable harm would result before the matter could proceed to a hearing. A TRO has the same force and effect as a preliminary injunction and remains in effect until an order can be issued granting or denying a preliminary injunction.

We therefore order PG&E and Edison to appear at an evidentiary hearing scheduled for January 29, 2001 at 10:00 a.m. to show cause as to why a preliminary injunction should not be issued.

We expect the utilities to fully comply with our orders. We have previously stated that nothing in AB 1890 relieves the existing utilities of their obligation to serve all customers in their service territories under their respective tariffs (D.97-09-047, mimeo. at p. 44.). In PG&E's holding company decision, D.98-04-068, the Commission specifically found that: "The capital requirements of PG&E, as determined to be necessary and prudent to meet the obligation to serve or to operate the utility in a prudent and efficient manner, shall be given first priority by PG&E Corporation's Board of Directors." (*Id.*, at 98.) The Commissions' holding company decision clearly affirms the continuing obligation to serve.

V. Unforeseen Emergency Situation

Government Code § 11125.5 and Rule 81 of our Rules of Practice and Procedure allow the Commission to take action more quickly than would be permitted if advance publication were made on the regular meeting agenda. An

example of such an unforeseen emergency situation are those activities that severely impair or threaten to severely impair public health or safety.

As underscored by Governor Gray Davis, who declared a state of emergency, this is such a situation. If PG&E and Edison were to rely only on their own generation to meet their obligations to serve all customers in their service territory, reliability of service would be severely undermined.

Draft decisions are generally subject to a 30-day review and comment period (§ 311(g)(1)). However, § 311(g)(2) provides that this 30-day period may be reduced or waived in an unforeseen emergency situation. We have determined that this situation exists and therefore waive the public review and comment period on this draft decision. (See also Rules 77.7(f)(1), 77.7(f)(9) and 81.)

Findings of Fact

1. On January 3, 2001, in final oral argument before the Commission on the proposed decision of ALJ Minkin in this proceeding, attorney Henry Weissmann, representing Edison, stated that if the Commission's decision prevented Edison from obtaining additional financing, it would not be able to buy power to meet its customers needs. He requested the Commission relieve Edison of the obligation to serve to the extent it cannot purchase power in excess of the 7 cents per kilowatt hour available in retail revenues to pay for power.

2. In D.01-01-018, we state that the interim surcharge of 1 cent per kilowatt hour, subject to refund and adjustment, is adopted to improve the ability of PG&E and Edison to cover the costs of procuring future energy in wholesale markets that they cannot produce themselves to serve their loads.

3. In D.01-01-018, we find that the utilities understood the risks AB 1890 and electric restructuring imposed. In addition, while the cash on hand in the holding companies may be insufficient when compared with the going-forward

costs of procuring power, we are convinced that other potential solutions should be and are currently being explored.

4. The evidence obtained at hearing in this proceeding does not support a finding that PG&E or Edison cannot continue to provide service unless there are substantial rate increases. Instead, we called for an audit and must await the independent auditors' report. Moreover, we do not have all of the facts related to the parent companies, the utilities, the affiliates, and the flow of funds among these entities. The independent auditors will also consider these questions in their reports.

5. On January 18, we received a declaration from Gary Heath, Executive Director of the EOB regarding PG&E's assertion to the Deputy Director Raymond Hart of the CDWR.

6. Mr. Hart informed Mr. Heath that PG&E stated that beginning January 20, 2001, PG&E would schedule only its own generation and would not purchase additional needed generation to serve remaining customer load. Mr. Heath verified this assertion with PG&E Vice President Dan Richard at 2:15 p.m. on January 18, 2001.

7. Mr. Heath states that PG&E cannot rely on its own generation to meet its obligations to serve all the customers in its service territory. If PG&E does not obtain additional generation, reliability of service to PG&E customers will be jeopardized.

8. We also received affidavits on January 18, 2001 from Terry Winter, the President and Chief Executive of the ISO and Ziad Alaywan, Managing Director of the ISO.

9. Mr. Winter declares that Harold Ray, a senior vice president of Edison, stated in a 4:15 p.m. telephone call on January 18, 2001, that Edison plans to continue to act as scheduling coordinator for all of Edison's non-direct access

customers. Mr. Ray stated that there is not an intent to abandon any of its customers.

10. At 4:20 p.m. on January 18, 2001, Mr. Winter had a telephone conversation with Mr. Richard of PG&E and Bruce Worthington, General Counsel of PG&E. Mr. Richard stated that PG&E would not change its scheduling responsibilities at this time and that there was a misunderstanding of the scheduling coordination responsibilities regarding the CDWR's role as a conduit to serve some of PG&E's customers.

11. Mr. Winter declares that Mr. Richards then advised the ISO that PG&E "will continue to review its scheduling coordination responsibilities to its non-direct access customers as the situation unfolds."

12. Mr. Alaywan declares that he participated in two conference calls with personnel from PG&E, Edison, and CDWR, which took place at approximately 8:00 a.m. and 2:00 p.m.

13. During the morning call, all participants agreed that PG&E and Edison would continue to act as scheduling coordinators for all their non-direct access customers, even though some customers would be served by generation provided by CDWR. PG&E and Edison agreed to undertake an inter-scheduling coordinator trade with CDWR in accordance with prescribed ISO processes.

14. During the afternoon call, Mr. Alaywan states that a PG&E director indicated that PG&E no longer wished to act as a Scheduling Coordinator for non-direct access customers served by generation provided by CDWR.

15. The same participants took part in a 3:00 p.m. conference call on January 18, 2001, in which Edison now indicated that it was taking the same position as PG&E as to scheduling coordinator responsibilities. Mr. Ziad understands from conversations with Mr. Winter that PG&E and Edison have currently indicated that they will serve as scheduling coordinators for all their non-direct access

customers in accordance with the process agreed to during the January 18, 2001 morning call.

16. The January 18, 2001 declaration of Peter Garris of the CDWR confirms the 2:00 p.m. phone call described by Mr. Alaywan. Mr. Garris also participated in a 4:45 p.m. conference call with Ms. Grief Director of PG&E Scheduling, PG&E Vice President Roy Kuga, other CDWR staff, and individuals from the ISO and Power Exchange.

17. During this call, Mr. Garris confirms that Mr. Kuga indicated that PG&E would not take scheduling coordinator trades from CDWR after Saturday, January 20, 2001, for energy acquired by CDWR for PG&E's load that is not served by PG&E's own generation.

18. Mr. Garris states that PG&E lacks sufficient resources to meet its native load without securing energy from other sources; if this is left unresolved, PG&E's customers will experience adverse reliability problems.

Conclusions of Law

1. State law clearly requires utilities to serve their customers, and a threatened bankruptcy filing or threat of insolvency does not change that obligation.

2. As we stated in D.01-01-018, we have a duty to assure that the utilities are able to continue to procure and deliver power for their customers. This duty applies even if the utilities under our jurisdiction have filed for bankruptcy or appear to be threatened with insolvency. Our basic duty under the Public Utilities Act is to assure the people of California adequate electric service at just and reasonable rates.

3. Under Public Utilities Code sections 451, 761, 762, 768, and 770, PG&E and Edison have an obligation to provide full and adequate service to all of their customers, including continuing to enter into and maintain any current and future low-cost contracts to procure power.

4. Electricity is essential to the health, safety, and economic well-being of all California consumers.

5. Customers of PG&E and Edison would suffer irreparable harm if the utilities did not maintain adequate service to all customers.

6. In order to ensure full and adequate service to all customers of PG&E and Edison, the Commission should issue a Temporary Restraining Order preventing the utilities from refusing to provide adequate service to all of their customers. This restraining order should specifically prevent the utilities from refusing to act as scheduling coordinator with the California Independent System Operator to serve all of their non-direct access customers.

7. A TRO serves the purpose of preventing the actions of a party from causing irreparable harm to another party, pending a hearing on the need for a preliminary injunction.

8. We are issuing this TRO on our own motion and an ex parte basis because we are convinced that if adequate service were not maintained, great or irreparable harm would result before the matter could proceed to a hearing.

9. A TRO has the same force and effect as a preliminary injunction and remains in effect until an order can be issued granting or denying a request for a preliminary injunction.

10. A hearing should be held expeditiously to require PG&E and Edison to show cause as to why a preliminary injunction should not be granted.

11. Nothing in AB 1890 relieves the existing utilities of their obligation to serve all customers in their service territories under their respective tariffs.

12. Consistent with Government Code § 11125.5 and Rule 81, immediate action is required because PG&E and Edison's potential failure to serve all non-direct access customers is an unforeseen emergency situation that threatens to severely impair public heath and safety.

13. Because this is an unforeseen emergency situation, the 30-day public review and comment period is waived, consistent with § 311(g)(2).

14. This order should be effective today, so that a temporary restraining order may be issued expeditiously.

INTERIM ORDER

IT IS ORDERED that:

1. Pacific Gas and Electric Company (PG&E) and Southern California Edison Company (Edison) shall continue to provide full and adequate service to all their customers.

2. PG&E and Edison are temporarily restrained from refusing to provide adequate service to all customers, including refusing to act as scheduling coordinators to serve all their non-direct access customers with the California Independent System Operator.

3. PG&E and Edison shall appear for an evidentiary hearing on January 29, 2001 at 10:00 AM at the Commission's San Francisco Courtrooms to show cause why the Commission should not proceed to issue a preliminary injunction and to take legal action against PG&E and Edison for their actions.

This order is effective today.

Dated January 19, 2001, at San Francisco, California.

LORETTA M. LYNCH
President
CARL W. WOOD
Commissioner

Commissioner Richard A. Bilas is necessarily absent.

I will file a dissent.

/s/ HENRY M. DUQUE
Commissioner

ATTACHMENT 1
DECLARATION

I, GARY HEATH, declare:

1. I am employed by the Electricity Oversight Board as the Executive Director. I have personal knowledge of the facts stated herein except as to matters stated upon information and belief, and as to those matters, I believe them to be true. If called upon to testify, I could and would competently do so.

2. Today, I received a telephone at about approximately 2:00 p.m. from Deputy Director Raymond Hart of the California Department of Water Resources.

3. Mr. Hart informed me that starting Saturday, January 20, 2001, Pacific Gas and Electric Company ("PG&E") told him that it would only schedule its own generation, and would not purchase additional needed generation to serve remaining customer load.

4. I verified this information from Mr. Hart by contacting PG&E Vice President Dan Richard, at approximately 2:15 p.m. today. Mr. Richard confirmed that PG&E would only serve its customers through its own generation, and therefore would not schedule the resources secured by the California Department of Water Resources for PG&E's remaining load.

5. PG&E cannot rely on its own generation to meet its obligations to serve all the customers in its service territory. PG&E must obtain additional generation; otherwise, reliability of service to PG&E customers will be seriously jeopardized.

I declare under penalty of perjury that the foregoing is true and correct. Executed this 18th day of January, 2001, at Sacramento, California.

/S/ GARY HEATH
Gary Heath

(END OF ATTACHMENT 1)

ATTACHMENT 2

AFFIDAVIT OF TERRY WINTER

I, Terry Winter, declare as follows:

1. I am the President and Chief Executive of the California Independent System Operator. I have personal knowledge of the matters set forth below and can testify thereto if called as a witness.

2. At approximately 4:15 on January 18, 2001, I had a telephone conversation with Harold Ray, a senior vice president of Southern California Edison Company (SCE) concerning that company's plans for acting as scheduling coordinator for all SCE non-direct access customers. Mr. Ray advised me that SCE is planning to continue to act as scheduling coordinator for all SCE non-direct access customers. Mr. Ray further advised me that any confusion on this point was due to some uncertainty as to how responsibilities for acting as scheduling coordinator would be allocated between the California Department of Water Resources and SCE. He advised me that there was no intent on the part of SCE to "abandon" any of its customers.

3. At approximately 4:20 on January 18, 2001, I had a conversation with Dan Richards, a senior executive of Pacific Gas and Electric Company (PG&E) and Bruce Worthington, General Counsel of PG&E, concerning that company's plans for acting as scheduling coordinator for all PG&E non-direct access customers. Mr. Richards advised me that PG&E would not change its scheduling coordinator responsibilities at this time. Mr. Richards further advised me that any confusion on this point was due to a misunderstanding of the scheduling coordination responsibilities of PG&E in light of the Governor's statement regarding the role of the California Department of Water Resources as a conduit to serve some of PG&E customers. Mr. Richards advised me that while the company does not intend to change its scheduling coordination role for all its non-direct access customers at this time, the company will continue to review its scheduling coordination responsibilities to its non-direct access customers as the situation unfolds.

Declared under penalty of perjury by:

/S/ TERRY WINTER
Terry Winter

(END OF ATTACHMENT 2)

ATTACHMENT 3

AFFIDAVIT OF ZIAD ALAYWAN

I, Ziad Alaywan, declare as follows:

1. I am a Managing Director at the California Independent System Operator. I have personal knowledge of the matters set forth below and can testify thereto if called as a witness.
2. On January 18, 2001, I participated in two conference calls with personnel from Pacific Gas and Electric Company (PG&E), Southern California Edison Company (SCE) and the California Department of Water Resources (CDWR), which took place at approximately 8:00 AM and 2:00 PM. These conference calls related to the mechanics for scheduling of non-direct access customers of PG&E and SCE.
3. During the morning call it was agreed that PG&E and SCE would act as scheduling coordinators for all their non-direct access customers, although some such customers would be served by generation provided by CDWR. PG&E and SCE would undertake an inter scheduling coordinator trade with CDWR to account for the generation to be provided by CDWR, in accordance with the ISO process for inter scheduling coordinator trades, which requires confirmation from both scheduling coordinators entering into a transaction.
4. During the 2:00 PM call, a PG&E director indicated that PG&E did not wish to act as scheduling coordinator for non-direct access customers served by generation provided by CDWR. This director stated that another entity should be used to act as scheduling coordinator for these customers. The CDWR representative asked whether PG&E was shirking its responsibilities as a utility. The PG&E director stated that PG&E does not wish to shirk its responsibilities, but stated again that another entity should serve as scheduling coordinator for customers served by CDWR generation. Since it appeared that the entities on the phone had reached an impasse, we agreed to try speaking again at 3:00 PM.
5. After the 2:00 PM call, I called another PG&E representative to get confirmation of the PG&E position. I was told that this person could not help me. I therefore informed the ISO President and Chief Executive Officer, Terry Winter, of the development.
6. The group (representatives from PG&E, SCE, CDWR and myself) reconvened for a call at 3:00 PM. During this call, the SCE representative indicated that it was taking the same position as PG&E as to scheduling coordination responsibilities, in light of issues that needed to be resolved, including for example the $100 penalty for underscheduling.
7. I understand from conversations with Mr. Winter that at this time PG&E and SCE have indicated that they will serve as scheduling coordinators for all their non-direct access customers in accordance with the process agreed to during the 8:00 AM call this morning.

Declared under penalty of perjury by:

/s/ ZIAD ALAYWAN

Ziad Alaywan

(END OF ATTACHMENT 3)

ATTACHMENT 4
DECLARATION

I, PETER GARRIS, declare:

1. I am employed by the California Department of Water Resources ("CDWR") as Chief Water and Power Dispatcher. I have personal knowledge of the facts stated herein except as to matters stated upon information and belief, and as to those matters, I believe them to be true. If called upon to testify, I could and would competently do so.

2. At approximately 2:00 p.m. today, I participated in a teleconference meeting with representatives from Pacific Gas and Electric Company ("PG&E"), Southern California Edison Company, the California Independent System Operator ("ISO") and the California Power Exchange ("PX"). During this meeting, Claudia Grief, Director of PG&E Scheduling, informed us that PG&E would not be taking "scheduling coordinator to scheduling coordinator trades" from CDWR to PG&E, as of Friday, January 19, 2001, for energy that would flow on Saturday, January 20, 2001. She also informed us that PG&E would not be the scheduling coordinator for load that could not be served by its own resources.

3. At approximately 4:45 p.m., I participated in a teleconference meeting with PG&E Vice President Roy Kuga and Ms. Grief. The meeting was attended by other CDWR staff, and individuals from the ISO and the PX. During this meeting, Mr. Kuga indicated that PG&E would not take "scheduling coordinator to scheduling coordinator trades" from CDWR after Saturday, January 20, 2001, for energy acquired by CDWR for PG&E's load that is not being served by PG&E's own generation.

4. PG&E lacks sufficient generating resources to meet its native load without securing energy from other sources, including CDWR. If the resource deficiency is unresolved, this will result in adverse reliability problems for PG&E customers.

I declare under penalty of perjury that the foregoing is true and correct. Executed this 18th day of January, 2001, at Sacramento, California.

/s/ PETER GARRIS
Peter Garris

(END OF ATTACHMENT 4)

Commissioner Duque, dissenting:

These are clearly stressful times. The Commission, and each Commissioner, wishes to do whatever we can to reduce the rolling blackouts that Californians are now facing. Nevertheless, I cannot support today's decision of the majority that adopts a Temporary Restraining Order (TRO) against SCE and PG&E.

A careful review of each of the affidavits attached to today's order of the majority belies the need for the issuance of a TRO. The affidavits document an understandable confusion on the part of SCE and PG&E concerning the new role of the California Department of Water Resources in buying power. More importantly, the affidavits show an underlying commitment by SCE and PG&E to honor their obligation-to-serve Californians. In particular, consider attachment 2, point 2 "there is no intent on the part of SCE to 'abandon' any of its customers." Furthermore, consider attachment 3, point 7 "... at this time, PG&E and SCE have indicated that they will serve as scheduling coordinators for all their non-direct access customers..." The affidavits demonstrate that there is no threat by either utility to deny their obligation-to-serve Californians. If there were such a threat by utilities to abrogate their obligation to serve, I would support the order of the majority. The evidence before the Commission, however, does not justify the issuance of a TRO.

It is also wise to ask what the adoption of this order will accomplish. The obligation-to-serve is already clear in California law, and the TRO adds nothing to that obligation. Moreover, the order may simply poison the atmosphere between government and the utilities, thereby making communications even more difficult in this time of crisis. Thus, the order of the majority is unwise, with potential risks and costs exceeding any benefits.

Finally, in the few minutes before this meeting, I called Gordon Smith, the CEO of PG&E. He stated that PG&E has no intention to abrogate its obligation-to-serve. I also called John Bryson, the Chairman of SCE, who said the same thing. These verbal commitments only confirm my reading of the affidavits and my conclusion that there is no need for today's order.

For these reasons, I respectfully dissent from today's order of the majority.

/s/ HENRY M. DUQUE

Henry M. Duque

January 19, 2001

San Francisco, California

TAB 12

EXHIBIT D

UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

Pacific Gas and Electric Company, PG&E Corporation On Behalf of its Subsidiaries Electric Generation LLC, ETrans LLC and GTrans LLC	Docket Nos. EC02-31-000 EL02-36-000 CP02-38-000

MOTION FOR SUMMARY DISPOSITION, OR IN THE ALTERNATIVE, PROTEST AND REQUEST FOR CONSOLIDATION AND HEARING, OF THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Pursuant to Rules 211, 212, and 217 of the Rules of Practice and Procedure ("Rules") of the Federal Energy Regulatory Commission ("FERC"), the Public Utilities Commission of the State of California ("CPUC"), hereby protests the filing made in the above-referenced dockets, and moves for the summary disposition of the application ("the section 203 application"). In the alternative, if the application is not summarily rejected, the CPUC requests that the application be consolidated with related filings discussed below, and set for consolidated hearing. The CPUC is a constitutionally-established agency charged with the responsibility for regulating natural gas and electric corporations within the State of California. In addition, the CPUC has a statutory mandate to represent the interests of natural gas and electric consumers throughout California in proceedings before the Commission. The CPUC previously filed a Notice of Intervention in these proceedings on December 14, 2001.

I. THE SECTION 203 APPLICATION

On November 30, 2001, Pacific Gas and Electric Company ("PG&E") and PG&E Corporation ("Parent") on behalf of its subsidiaries, Electric Generation LLC ("Gen"), ETrans LLC ("ETrans") and GTrans LLC ("GTrans") (collectively, "PG&E" or the "Applicants") filed an application with the FERC, pursuant to Section 203 of the Federal Power Act ("FPA") and related declaratory orders under Sections 201 and 305 of the FPA and Section 12 of the Natural Gas Act ("NGA") for authorization of a disposition of jurisdictional facilities (for convenience the application will be referred to herein as "the Section 203 Application"). Applicants state that this filing has been filed in connection with PG&E's proposed "Plan of Reorganization under Chapter 11 of the Bankruptcy Code for Pacific Gas and Electric Company" ("Plan") jointly filed by PG&E and its Parent with the Bankruptcy Court on September 20, 2001. Applicants request approval for various transactions in connection with a proposed reorganization of PG&E that would result in the corporate unbundling of certain of PG&E's operations and spin-off of PG&E (as a retail gas and electric distribution company) from the Parent. PG&E states in its application that it does not expect to seek approval of the Transaction by the CPUC.

Specifically, PG&E is seeking FERC approval in the instant application for:

- Transfer of transmission-related assets and wholesale and transmission contracts to Gen, the GenSub LLCs and ETrans and for the Spin-Off of a Reorganized PG&E from its Parent pursuant to FPA Section 203.
- Assignment of the beneficial interest in the Nuclear Decommissioning Trust associated with PG&E's Diablo Canyon Power Plant Nuclear Decommissioning Trust associated with PG&E's Diablo Canyon to Diablo Canyon LLC.
- A declaratory order that the GenSubs LLCs, will not be deemed "public utilities" under Section 201 (3) of the FPA, 16 U.S.C. § 824(3) (2000).
- A ruling that the declaration of a dividend to effectuate the transfer of Gen, the GenSub LLCs, ETrans and GTrans from PG&E to its Parent, distribution of a stock dividend by PG&E to its Parent, and the Parent's subsequent distribution to its shareholders of its shares of common stock of Reorganized PG&E, do not

violate the prohibitions set forth in Section 305(a) of the FPA, or Section 12 of the NGA.

- Confidential treatment to unredacted files that contain privileged or propriety material.
- Concurrent approvals with the FERC under Sections 8, 204 and 205 of the FPA, and Section 7 of the NGA, to implement specific aspects of the Bankruptcy Plan.
- A Final Order Approving PG&E's Application by the end of July 2002.

On December 12, 2001, the FERC issued its "Notice of Filing," setting until January 30, 2002, for the filing of interventions and protests in these dockets. The filing of the Section 203 Application is one part of a complex series of filings ("November 30 Filings") made by PG&E before the FERC as part of the implementation of PG&E's Plan. These filings are voluminous in nature—by PG&E's estimate, 20,000 pages.

The Plan was jointly filed by PG&E and the Parent with the Bankruptcy Court on September 20, 2001. PG&E's Plan involves a complex disaggregation of various businesses within PG&E and the spin-off of its distribution business to a Reorganized PG&E, which will be a separate company that will no longer be affiliated with the remainder of the disaggregated businesses. In effect, the current vertically-integrated PG&E will become a distribution company only and its generation, electric transmission and gas storage and transmission operations will be unbundled into separate companies that remain affiliated with one another under the Parent, but unaffiliated with Reorganized PG&E.

Under this Plan, only Reorganized PG&E will be subject to CPUC regulation. Indeed, as the CPUC has recently stated in its November 27, 2001 bankruptcy filing in response to PG&E's proposed disclosure statement:

> Through its Plan and Disclosure Statement PG&E seeks to affect a regulatory jailbreak unprecedented in scope in bankruptcy annals. Under the guise of section 1123(a)(5) of the Bankruptcy Code and through a misapplication of the debtor protection provisions of chapter 11, PG&E seeks sweeping preemptive relief primarily in

> the form of no fewer than fifteen affirmative declaratory and injunctive rulings, each designed to permanently dislocate various state and local laws and regulations affecting PG&E's operation of its public utility. (Fn omitted). PG&E's Plan is concerned only secondarily with adjusting debtor-creditor relations and restoring its utility operations to financial health. To be sure, if those were PG&E's primary concerns, then it would have proposed a much more straightforward reorganization strategy. PG&E has as its own agenda an escape from CPUC and State regulation.[1]

II. THE STATUS OF THE BANKRUPTCY PROCEEDINGS

Pursuant to an order of the Bankruptcy court, on December 19, 2001, PG&E filed its First Amended Disclosure Statement For First Amended Plan Of Reorganization ("Am. Discl. St."), describing the extent to which the Plan relies on preemption of state law and regulation. The CPUC filed its brief on preemption with the Bankruptcy Court on January 8, 2002, and the CPUC's brief on preemption was attached as Exhibit B to the "Joint Parties' Motion To Dismiss Applications, Or In The Alternative To Hold Applications In Abeyance And For Extension Of Time To Intervene, Protest, And Comment, And For Expedited Action And Shortened Response Time" ("Joint Motion") filed on January 22, 2002 in Docket Nos. ER02-455-000 et. al.

PG&E's Am. Discl. St. makes an extraordinarily broad claim of preemption, touching on fundamental aspects of century-old utility law regulation. PG&E asserts that:

> [t]he preemptive effect of the [proposed] Confirmation Order extends to all statutes, rules, orders and decisions of the CPUC otherwise applicable to the Restructuring Transactions and the implementation of the Plan. In the Proponents' view, the Confirmation Order supersedes any statute, rule, order or decision that the CPUC might interpret to otherwise apply to the Restructuring Transactions and the implementation of the Plan whether specified here or not.

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[1] See p. 3 of "California Public Utilities Commission's Objection to Proposed Disclosure Statement for Plan of Reorganization Under Chapter 11 of the Bankruptcy Code for Pacific Gas and Electric Company Proposed by Pacific Gas and Electric Company and PG&E Corporation." filed November 27, 2001, In re Pacific Gas and Electric Company, United States Bankruptcy Court Northern District of California, San Francisco Division , Case No. 01-30923 DM.

Am. Discl. St. at 129.

Specifically, PG&E asserts preemption of, among others, the following statutes, rules, decisions and regulations, which form the foundation of any state public utility code:

- **Public Utilities Code §377**: As amended in January 2001, § 377 requires the CPUC to "regulate the facilities for the generation of electricity owned by any public utility . . . until the owner of those facilities has applied to the commission to dispose of those facilities and has been authorized by the commission under Section 851 to undertake that disposal" and provides that "no facility for the generation of electricity owned by a public utility may be disposed of prior to January 1, 2006. The commission shall ensure that public utility generation assets remain dedicated to service for the benefit of California ratepayers."

- **Public Utilities Code §451:** Like § 205 of the FPA, requires utility rates to be just and reasonable, and provides that "Every public utility shall furnish and maintain such adequate, efficient, just, and reasonable service, instrumentalities, equipment, and facilities . . . as are necessary to promote the safety, health, comfort, and convenience of its patrons, employees, and the public."

- **Public Utilities Code §453:** Provides in relevant part that "No public utility shall, as to rates, charges, service, facilities, or in any other respect, make or grant any preference or advantage to any corporation or person or subject any corporation or person to any prejudice or disadvantage."

- **Public Utilities Code §701:** Provides that: "The commission may supervise and regulate every public utility in the State and may do all things, whether specifically designated in this part or in addition thereto, which are necessary and convenient in the exercise of such power and jurisdiction."

- **Public Utilities Code §701.5:** Provides for CPUC regulation of certain public utility financing arrangements.

- **Public Utilities Code §702:** Provides that "Every public utility shall obey and comply with every order, decision, direction, or rule made or prescribed by the commission in the matters specified in this part, or any other matter in any way relating to or affecting its business as a public utility, and shall do everything necessary or proper to secure compliance therewith by all of its officers, agents, and employees."

- **Public Utilities Code §728:** Similar to § 206 of the FPA, provides that "Whenever the commission, after a hearing, finds that the rates or classifications, demanded, observed, charged, or collected by any public utility for or in connection with any service, product, or commodity, or the rules, practices, or contracts affecting such rates or classifications are insufficient, unlawful, unjust, unreasonable, discriminatory, or preferential, the commission shall determine and fix, by order, the just, reasonable, or sufficient rates, classifications, rules, practices, or contracts to be thereafter observed and in force."

- **Public Utilities Code §761:** Along with §§ 762 and 768, provides for basic health, safety and reliability regulation of public utilities. The CPUC may order construction or modification of facilities or equipment, and changes to rules or services, in order to address "unjust, unreasonable, unsafe, improper, inadequate, or insufficient" utility rules, practices, equipment, appliances, facilities or service. Pub. Util. Code §§ 761, 762, 768. The

Commission may order changes in a utility's facilities to promote the security or convenience of employees or the public. Pub. Util. Code § 762. It may fix the utility's rules, practices, and service to promote safety, reliability, and other goals. Pub. Util. Code § 761. It may direct a utility to use particular safety devices (Pub. Util. Code § 768). The Commission may fix standards and services to be furnished by utilities. Pub. Util. Code § 770.

- **Public Utilities Code §816-830**: These sections govern the issuance by a public utility of debt or equity securities, among other things requiring the approval of the CPUC prior to the issuance.
- **Public Utilities Code §851:** Similar to § 203 of the FPA, provides that CPUC approval is required for any public utility to "sell, lease, assign, mortgage, or otherwise dispose of or encumber" its property, including certificates of public convenience and necessity.
- **CPUC Resolution L-244:** Issued in 1994, this CPUC decision prohibits PG&E from "taking any action that would alter the jurisdictional status of PG&E or any division of PG&E or of the rates, services or facilities of PG&E's natural gas transmission system or storage system without first obtaining the Commission's approval."

As the CPUC's President Lynch has stated to the Bankruptcy Court, these laws and regulations "establish the fundamental relationship between the State of California and its regulated public utilities," including the "the utilities' basic obligation to provide electric and gas service to every California customer on a fair and non-discriminatory basis." See e.g. Order Instituting Investigation Into the Power Outage et al., D.99-09-028, 1999 Cal. PUC LEXIS 635, *8-26 (1999). As discussed in the Joint Motion, the CPUC, the State of California representing other state agencies, and others have objected that PG&E's unlawful misuse of the Bankruptcy Code renders the Plan unconfirmable on its face. That is, under existing law, the Bankruptcy Court cannot lawfully approve the Plan as proposed. In particular, the Ninth Circuit has held in Baker & Drake Inc. v. Public Service Commission of Nevada, 35 F.3d 1348 (9th Cir. 1994), that the Bankruptcy Code does not preempt state statutes or regulations intended to protect the public safety and welfare. According to the Ninth Circuit, state statutes may be preempted by the Bankruptcy Code only if, at a minimum, they are directed narrowly and solely at economic regulation, and if certain other factors apply. The provisions of the Public Utilities Code that PG&E seeks to preempt protect the public safety and welfare, and accordingly preemption

cannot occur. That is true even if enforcement of the challenged provisions of state law would make a bankruptcy reorganization more difficult, or even impossible.

In addition, the CPUC has developed and is prepared to file in short order an Alternative Plan of Reorganization ("Alternative Plan"). Unlike the PG&E Plan, the Alternative Plan does not require disassembling the nation's largest public utility, and does not require either the Bankruptcy Court or FERC to reject the application of century-old state regulatory statutes critical to health, safety, and welfare of thirty million citizens. The Bankruptcy Court provided the CPUC until February 13, 2002 to provide the Bankruptcy Court with a term sheet demonstrating that the CPUC's proposed Alternative Plan is feasible. Upon review of the term sheet, the Bankruptcy Court will rule on whether the CPUC will be permitted to file the Alternative Plan.

A hearing on the preemption issues was held on January 25, 2002. The Bankruptcy Court has taken the matter under submission.

III. OVERVIEW OF PLEADING

The CPUC moves to dismiss the Section 203 Application, and protests each of the requested authorizations at issue in the section 203 application. Dismissal is sought on the grounds that, inter alia: (1) the Section 203 Application is premature; (2) the transactions for which authorization is sought in the Section 203 Application and the related November 30 Filings contravene the public interest or otherwise violate the law, among other things violating fundamental provisions of state law and creating significant regulatory gaps; (3) PG&E has failed to comply with applicable FERC regulations, including 18 C.F.R. 33.2(e)(3); (4) serious environmental issues are implicated by the transfer of PG&E's hydroelectric facilities to non-

regulated limited liability companies;[2] (5) FERC cannot lawfully authorize the requested assignment of the Nuclear Decommissioning Trusts; and (6) the proposed Transactions violate § 305 of the FPA

In the event that dismissal is not granted, the CPUC moves to consolidate the November 30 Filings, and that the consolidated proceedings be set for hearing. As the various dockets commenced by means of the November 30 Filings constitute interrelated parts of a single Plan, consolidation is warranted. In addition, significant issues having been raised in the instant pleading and the CPUC's contemporaneously filed pleadings in each docket, in the event that the proceedings are not simply dismissed hearings are necessary to fully evaluate whether PG&E's proposals are in the public interest and are otherwise lawful.

IV. MOTION FOR SUMMARY DISPOSITION

The CPUC submits that the section 203 application must be summarily rejected in its entirety. First, the CPUC renews the arguments made in the Joint Motion for dismissing the Gen application as premature, or alternatively, holding this proceeding in abeyance, and incorporates the Joint Motion herein by this reference.[3]

Second, the Section 203 Application must be summarily dismissed on the merits, because the transactions detailed in the Plan, which are proposed to be implemented in part through the

[2] PG&E owns the largest private system of hydroelectric facilities in the nation. Consisting of 250 dams and diversions, 99 reservoirs with 2.3 million acre-feet of storage capacity and 200,000 acre-feet of consumptive water rights, and 68 powerhouses with 3,896 megawatts of generation capacity, the system controls Sierra and other rivers from Mt. Shasta to the Kings River Basin near Bakersfield. In addition, it includes 140,000 acres of associated lands.

[3] PG&E argues, in effect, that although its plan currently seeks to violate state law in numerous ways, it will become lawful if the Bankruptcy Court confirms the plan, including PG&E's request for a declaration that all applicable state law is preempted. This argument, if accepted, merely demonstrates why this application should be dismissed as premature. PG&E's own timetable does not contemplate execution of the plan for at least another eleven months. And even if the Bankruptcy Court does ultimately confirm the plan, its legality still will be subject to years of appeals. At the present time, it is indisputable that the object of this application is unlawful, and unless and until the Bankruptcy Court states otherwise, and the judgment of the Bankruptcy Court is affirmed, PG&E's claims concerning the legality of this application are hypothetical and speculative at best.

Section 203 Application, are contrary to the public interest, as expressed in both state and federal law and regulation. The purpose of the transactions at issue here is, inter alia, to allow PG&E to transfer its generation, electric transmission, and natural gas transportation assets to affiliates of PG&E Corporation, currently PG&E's parent. As to the electric generation assets, the proposed transactions directly violate both California statutory law and clearly expressed federal policy. Both the California Legislature and FERC have recognized that the particular circumstances that obtain in California's energy markets at this time strongly dictate against a utility divesting itself of all of its own generation assets, as this application seeks authorization to do. As to the natural gas transportation assets, the proposed transactions similarly violate state law. In addition, the PG&E Plan violates numerous other state laws, both substantive and procedural. Moreover, the federal statutes under which these transactions are proposed demonstrate a keen respect for state regulation of public utilities, and cannot be utilized in the manner proposed herein.

In January 2001, the California State Legislature enacted Assembly Bill (AB) X1 6, which prohibits California's investor-owned utilities, including PG&E, from disposing of generation facilities that they own before January 1, 2006, providing in relevant part: "Notwithstanding any other provision of law, no facility for the generation of electricity owned by a public utility may be disposed of prior to January 1, 2006." Cal. Pub. Util. Code § 377. The application at issue here seeks FERC approval of transactions for the purpose of violating that statute, and numerous others. Accordingly, the object of the transactions that PG&E asks FERC to authorize in this proceeding is patently unlawful. Moreover, PG&E concedes that it has not and will not seek any authorizations from the CPUC. A partial list of the statutes that its plan violates is set forth above, including Cal. Pub. Util. Code § 851 (similar to FPA § 203, requiring CPUC approval for any disposition of utility property). Not mentioned in the PG&E

plan, though equally critical, is the attempted circumvention of the California Environmental Quality Act ("CEQA") Cal. Pub. Res. Code § 21000, et. seq., which is triggered under CPUC § 851 reviews. California has a strong interest in ensuring compliance with CEQA in order to weigh the potential environmental impacts of a proposed utility transaction and by doing so, ensure that the State protects its environment and inhabitants from unnecessary harm. PG&E's preemption claim attacks California's basic power to protect the public against the danger that a utility will fail to carry out its duties, or the danger that a utility transaction will have an adverse impact on the environment.

FERC has previously reached a conclusion similar to that reached by the California Legislature last January. In an order dated December 15, 2000, FERC noted that utility retained generation was an important factor in mitigating wholesale power costs, and thus in ensuring utilities' ability to provide required services. San Diego Gas & Electric Company, et al., 93 FERC ¶ 61,294 (2000) at 62,001 (As a result of the order, "the IOUs will be able to provide power from their own resources to serve their own load . . . . The best way to mitigate cost exposure is for the IOUs to cease selling and repurchasing what they already produce"). FERC thus ordered PG&E to utilize its retained generation to serve its native load. Id. PG&E's Plan, in contrast, would effectively reverse this aspect of the December 15 Order, and leave the nation's largest utility virtually devoid of generating facilities.

Similarly, well-established California law and regulations prohibit the changes in status sought in Docket Nos. CP02-38-000 et al. for PG&E's natural gas transportation facilities in the absence of CPUC approval.[4] CPUC Resolution L-244, issued in 1994, prohibits PG&E from

[4] Decisions of the CPUC have the force of state law. Dyke Water Co. v. Public Utilities Com. (1961) 56 Cal.2d 105, 123 (CPUC rule "had the force and effect of a statute"); Colich & Sons, et al. v. Pacific Bell (1988) 198 Cal.App.3d 1225, 1232, citing Dollar-A-Day Rent-A-Car System, Inc., v. Pacific Tel. & Tel. Co. (1972) 26 Cal.App.3d 454, 457.

"taking any action that would alter the jurisdictional status of PG&E or any division of PG&E or of the rates, services or facilities of PG&E's natural gas transmission system or storage system without first obtaining the Commission's approval." Resolution L-244 was premised on the CPUC's concern that such an action by PG&E "may engender significant adverse impacts on California citizens," including "the possibility that the Commission will be unable to ensure the provision of gas to homes, schools, and hospitals in the case of a supply or capacity crisis" and "the possibility that the pricing of gas service for captive customers will undermine the universal availability of affordable gas service for California citizens." PG&E has neither sought nor obtained CPUC approval for such a change.

PG&E acknowledges that the Plan violates state law. The Section 203 Application states, for instance, that:

> "If the Debtor were not subject to the jurisdiction of the Bankruptcy Court, under the Public Utilities Code the approval of the CPUC would be required to transfer the generation assets from the Debtor to Gen and its subsidiaries or affiliates and to otherwise effect the Restructuring Transactions. In addition, Section 377 of the California Public Utilities Code states that the Debtor is required to retain its remaining generation assets through 2005.

Am. Discl. St. at 100.

The relief PG&E demands not only violates state law and FERC's December 15 Order, but would undermine Congressional intent to preserve the traditional police power of the states to the greatest extent Constitutionally permissible. Courts have repeatedly recognized the important role of state regulation of public utilities, and that federal law was meant to supplement and not to supplant state regulation of those utilities. The FPA and NGA were enacted to fill in gaps not covered by state regulation, not as a mechanism for avoiding state regulation of public utilities. In enacting Part II of the Federal Power Act, Congress did not purport to exercise all of the authority it might have exercised under the Commerce Clause,

because its intention was to preserve, not override, state regulatory jurisdiction. Conn. Light & Power Co. v. Federal Power Comm'n, 324 U.S. 515, 529-30 (1945). To implement this intent, the "limitations established on [federal commission] jurisdiction . . . were designed to coordinate precisely with those [the *Attleboro* line] constitutionally imposed on the states." United States v. Public Utils. Comm'n of California, 345 U.S. 295, 311 (1953) ("U.S. v. CPUC"); Conn. Light & Power, 324 U.S. at 525 ("Progress of the [FPA] bill through various stages shows constant purpose to protect rather than to supervise authority of the states."); Panhandle E. Pipe Line Co. v. Pub. Serv. Comm'n, 332 U.S. 507, 517-518 (1947) (NGA "was drawn with meticulous regard for the continued exercise of state power, not to handicap or dilute it in any way."); FPC v. Southern California Edison Co., 376 U.S. 205, 213 (1964) ("The premise was that constitutional limitations upon state regulatory power made federal regulation essential if major aspects of interstate transmission and sale were not to go unregulated").

Both the FPA and the NGA are replete with provisions that demonstrate the Congressional concern that federal regulation not be used as a mechanism to avoid state regulation of public utilities. Section 201 of the FPA, for instance, is the basic provision providing for federal regulation of electricity. Section 201(a) provides that "the transmission of electric energy in interstate commerce and the sale of such energy at wholesale in interstate commerce is necessary in the public interest, such Federal regulation, however, to extend only to those matters which are not subject to regulation by the States." Section 201 thus explicitly provides for the continued exercise of traditional regulatory authority by the States.[5] See Conn. Light & Power, 324 U.S. at 529-30.

[5] FPA Sections 19 and 20 contain similar provisions. See also Section 204(f).

Similarly in enacting the NGA, Congress created a dual regulatory scheme which "carefully divided up regulatory power over the natural gas industry." Northwest Central Pipeline Corp. v. State Corp. Comm'n, 489 U.S. 493, 510 (1989). Congress "prescribe[d] not only the intended reach of the [federal power]," but also "specifie[d] the areas in to which this power was not to extend." Id.; Kentucky West Virginia Gas Co. v. Pennsylvania Public Utility Commission, 650 F. Supp. 659, 667 (M.D.Pa 1996). For instance, in § 1(b) Congress specifically stated that federal regulation "shall not apply . . . to the local distribution of natural gas." Northwest Central, 489 U.S. at 511 (Congress places express jurisdictional limits on federal powers in §1(b) of NGA). Under Section 1(c), known as the Hinshaw Amendment, Congress similarly fenced off from federal regulation "any person engaged in the transportation in interstate commerce or the sale in interstate commerce for resale of natural gas received by such person from another person within or at the boundary of a state if all the ...gas...is ultimately consumed within such State." Congress expressly "declared [such regulation] to be matters of primarily of local concern and subject to regulation by the several States." [6]

In the same vein is § 32 of the Public Utility Holding Company Act ("PUHCA"), enacted as part of the Energy Policy Act of 1992, 15 U.S.C. § Sec. 79z-5a(c). This section of the Energy Policy Act provides that:

> If a rate or charge for, or in connection with, the construction of a facility, or for electric energy produced by a facility (other than any portion of a rate or charge which represents recovery of the cost of a wholesale rate or charge) was in effect under the laws of any State as of October 24, 1992, in order for the facility to be considered an eligible facility, every State commission having jurisdiction over any such rate or charge must make a specific

[6] PG&E has continuously been a Hinshaw pipeline since 1954 and subject to CPUC regulation. PG&E is a local distribution company of natural gas regulated by the CPUC. See Cal. P.U. Code §§ 451, 454, 785.5. PG&E's sales are sales for ultimate consumption by California consumers. As such, PG&E's sales and rates are exclusively regulated by the CPUC. See also the CPUC's contemporaneous filing in Docket Nos. CP02-39-000 et al.

> determination that allowing such facility to be an eligible facility: (1) ill benefit consumers, (2) is in the public interest, and (3) does not violate State law.

Section Sec. 79z-5a(c) not only contemplates recognition of state interests, but enshrines in federal law the principle that the state must affirmatively give its consent in order for a utility to effectuate a change in status of the kind sought here of any rate-based electric generating facility.[7] Here, of course, not only has PG&E not sought such consent, it seeks to transfer its generating facilities out of state regulation over the objection of its state regulator, and in the face of state law prohibiting the transaction.

Bankruptcy law in the Ninth Circuit, moreover, does not countenance the flouting of state law inherent in PG&E's Plan. The Ninth Circuit has held in Baker & Drake Inc. v. Public Service Commission of Nevada, 35 F.3d 1348 (9th Cir. 1994), that the Bankruptcy Code does not preempt state statutes or regulations intended to protect the public safety and welfare. According to the Ninth Circuit, state statutes may be preempted by the Bankruptcy Code only if, at a minimum, they are directed narrowly and solely at economic regulation, and if certain other factors apply. As discussed above, the provisions of the Public Utilities Code that PG&E seeks to preempt protect the public safety and welfare, and form the foundation of any system of public utility regulation. See also Northeast Utilities Service Company v. FERC, 993 F.2d 937, 945-46 (1st Cir. 1993) ("there is no evidence that the state regulators would have approved a plan to allow PSNH to emerge from bankruptcy that included only the first 'stand alone' step"); In re Nitec Paper Corp., 43 B.R. 492 (S.D.N.Y. 1984) ("a reorganization must be formulated within the bounds of existing state and federal law").

[7] In apparent recognition of this fact, PG&E does not seek EWG status for the GenSub LLCs.

In sum, state law prohibits implementation of some of the transactions proposed in the Section 203 Application (and the related November 30 Filings) outright, and requires CPUC approval for others (which PG&E has not sought and says it will not seek). Federal public utility law recognizes the continued importance and vitality of state regulation, and requires FERC to consider the expressed interest of the state in any determination that it makes. Federal bankruptcy law similarly forbids debtors and courts from overriding the state's expressed interest. Finally, FERC itself is on record as determining that PG&E's retained generation must be used to serve native load. These factors lead ineluctably to the conclusion that the transactions proposed PG&E's Section 203 Application are not in the public interest, and the Application should be dismissed.

V. ALTERNATIVE MOTION TO CONSOLIDATE NOVEMBER 30 FILINGS FOR HEARING

The CPUC seeks dismissal of the Section 203 Application as set forth above, and seeks dismissal, on various grounds set forth in pleadings filed contemporaneously with the instant pleading, of each of the proceedings arising from the November 30 Filings. If the Section 203 Application is not dismissed, it and any of the other proceedings arising from the November 30 Filings which are not summarily dismissed should be consolidated and set for hearing.[8]

The November 30 filings are interrelated pieces of a single coordinated program, intended to implement PG&E's Plan. No single docket among the November 30 Filings can be evaluated in isolation, any more than the various aspects PG&E's Plan could be evaluated singly.

[8] The dockets as to which dismissal, or in the alternative, consolidation and hearing, are sought are: ER02-455-000 (ETtrans); ER02-456-000 (Gen); CP02-39-000, CP02-40-000, CP02-41-000, CP02-42-000 (GTrans et al.); EC02-31-000, EL02-36, CP02-38-000 (Section 203); ES02-17 (Section 204); Project Nos. 77-116, 96-031, 137-031, 175-018, 178-015, 233-082, 606-020, 619-095, 803-055, 1061-056, 1121-058, 1333-037, 1354-029, 1403-042, 1962-039, 1988-030, 2105-087, 2106-039, 2107-012, 2130-030, 2155-022, 2310-120, 2467-016, 2661-016, 2687-022, 2735-071, 233-081, 1354-005, 2107-010, 2661-012, 2687-014, 2118-006, 2281-005, 2479-003, 2678-001, 2781-004, 2784-001, 4851-004, 5536-001, 5828-003, 7009-004, and 10821-002 (Section 8).

For instance, to fully evaluate the ETrans application in Docket No. ER02-455-000 consideration must also be given to the transfer of transmission assets and contracts proposed in the Section 203 Application. The contracts for which approval is sought in the ETrans Application flow from the dispositions proposed in the Section 203 Application. Similarly, the PSA proposed in the Gen Application cannot be fully evaluated without consideration of issues raised in the instant proceeding, since it is by means of this proceeding that PG&E proposes to transfer certain jurisdictional facilities necessary to support the PSA. Moreover, it is in this proceeding that the issue of whether PG&E's proposed transactions provide adequate compensation to PG&E will be raised.

Likewise, while the Section 8 Applications address only the requested approval to transfer hydroelectric project licenses, the Section 203 Application contains the associated request to transfer to Gen and its subsidiaries certain hydroelectric assets. That application additionally requests a disclaimer by the FERC of any jurisdiction under the FPA over the LLCs which are to hold the hydroelectric FERC licenses. Section 203 Application at 82-83. The Section 204 and 305 Applications request approval regarding the issuance of securities and the assumption of liability by Gen in connection with the transfer.

These applications will require coordinated review and scrutiny to adequately evaluate the difficult legal issues they raise and in order to ultimately determine whether PG&E's filings are in the public interest. Indeed, PG&E asks for "concurrent approvals" of its various November 30 Filings. Accordingly, the November 30 Filings should be consolidated. See Northeast Utilities Service Company v. FERC, 993 F.2d 937, 945-46 (1st Cir. 1993) ("like the state regulators who approved the two-step plan, the Commission evaluated the plan as a whole").

FERC precedent supports setting related dockets of similar magnitude for consolidated hearing. See Northeast Utilities Company, 50 FERC ¶ 61,266 (1990) (establishing consolidated hearing procedures for several related proceedings proposed to implement a bankruptcy Plan of Reorganization for Public Service of New Hampshire). The CPUC has raised serious issues regarding whether, for instance, the contracts filed in the ETrans and Gen applications may be considered just and reasonable. Moreover, FERC's policy is to set § 203 proceedings for hearing if issues are raised by a state commission regarding the effect of the proposed transaction on state regulation. See e.g. Ohio Edison Company, 95 FERC ¶ 61,178 (2001) (hearing not necessary because Ohio Commission had jurisdiction over the transaction and did not raise concerns about the effect on regulation); Merger Policy Statement, 77 FERC ¶ 61,263 (1996); Revised Filing Requirements Under Part 33 of the Commission's Regulations, 93 FERC ¶ 61,164 (2000). As set forth above, PG&E contends that the preemptive force of the Bankruptcy Code deprives the CPUC of the authority it would otherwise have over the transactions proposed in the November 30 Filings. And, as discussed in detail below, the Section 203 Application has serious detrimental impacts on both state and federal regulation, creating a significant regulatory gap with respect to, inter alia, PG&E's generation facilities. Accordingly, although the CPUC disputes PG&E's contention as to the preemptive force of the Bankruptcy Code, the CPUC does seek significant relief herein. Consequently, the November 30 Filings should be set for a consolidated hearing with attendant discovery opportunity and procedures consistent with Northeast Utilities Company, 50 FERC ¶ 61,266 (1990).

VI. THE AUTHORIZATIONS SOUGHT IN SECTION IV OF THE APPLICATION CONTRAVENE THE PUBLIC INTEREST

The transactions proposed in the Section 203 Application raise serious concerns with respect to each of the three factors traditionally considered by FERC in a § 203 proceeding,

producing detrimental effects on competition and rates, and creating substantial regulatory gaps. San Diego Gas & Electric Co. 79 FERC ¶ 61,372 (1997) ("SDG&E"). In addition, other factors relevant in this matter to any public interest determination weigh heavily against approval of the authorizations sought by PG&E. 18 C.F.R. 2.26(b). The Section 203 Application proposes that PG&E divest itself of its most valuable assets for a fraction of their value, while retaining billions of dollars worth of liabilities. Moreover, adequate protection of the public interest requires that the environmental implications of the proposed transactions be fully considered. Finally, approval of the Section 203 Applications is inconsistent with the prompt emergence from Bankruptcy of PG&E. As in the SDG&E case, FERC must act in partnership with the state to assure that the public interest is fully protected. Each of these issues is discussed in greater detail below.

A. The Standard of Review

FERC analyzes proposed dispositions under § 203 to determine whether they are "consistent with the public interest." Section 203 provides in relevant part:

> (a) Authorizations
>
> No public utility shall sell, lease, or otherwise dispose of the whole of its facilities subject to the jurisdiction of the Commission, or any part thereof of a value in excess of $50,000, or by any means whatsoever . . . merge or consolidate such facilities or any part thereof with those of any other person . . . without first having secured an order of the Commission authorizing it to do so. Upon application for such approval the Commission shall give reasonable notice in writing to the Governor and State commission of each of the States in which the physical property affected, or any part thereof, is situated, and to such other persons as it may deem advisable. After notice and opportunity for hearing, if the Commission finds that the proposed disposition, consolidation, acquisition, or control will be consistent with the public interest, it shall approve the same.

(b) Orders of Commission

> The Commission may grant any application for an order under this section in whole or in part and upon such terms and conditions as it finds necessary or appropriate to secure the maintenance of adequate service and the coordination in the public interest of facilities subject to the jurisdiction of the Commission. The Commission may from time to time for good cause shown make such orders supplemental to any order made under this section as it may find necessary or appropriate.

FERC primarily examines three factors in analyzing whether a proposed transaction is consistent with the public interest: (1) the effect on competition, (2) the effect on rates, and (3) the effect on regulation. FERC "may also consider other factors" in determining whether a proposed transaction is in the public interest. 18 C.F.R. 2.26(b).

FERC's discussion of these factors in the SDG&E/Enova-Pacific Enterprises merger proceeding is instructive. See San Diego Gas & Electric Co. 79 FERC ¶ 61,372 (1997) ("SDG&E"). In the SDG&E case, the holding companies of two of California's largest public utilities (SDG&E and Southern California Gas Co.) proposed to merge. FERC expressly referenced the CPUC's authority in considering each public interest factor. Under the first factor, "effect on competition" FERC looked at both vertical and horizontal market power. FERC stated that "vertical mergers raise three types of general competitive concerns: (1) denying rival firms access to inputs or raising their input costs; (2) increased anticompetitive coordination; and (3) regulatory evasion." FERC concluded that the merger could have impacts on competition, and further concluded that most of the mitigation measures it thought necessary were within the CPUC's jurisdiction. Thus FERC conditioned its approval of the merger on the adoption by the CPUC of certain mitigation measures. Id. at 62,565. As to horizontal market power, FERC noted that consolidation of retail gas services of SDG&E and SoCalGas due to the merger could reduce competition, but held that "the California Commission, which also has

jurisdiction over this transaction, can adequately address this issue and has not requested our assistance in this regard."

Under the second fact, "effect on rates," FERC noted that the only issue appeared to relate to retail rates, a matter "more appropriately addressed by the California Commission." Id. at 62,566.

Under the third factor, "effect on regulation," FERC's Merger Policy Statement discusses concerns relating to (1) creation of a regulatory gap as a consequence of a corporate realignment, or (2) shifts of regulatory authority between FERC and state commissions or the Securities and Exchange Commission (SEC). FERC found it dispositive in the SDG&E proceeding that "the California Commission has not raised concerns regarding impairment of its regulatory authority and will be able to approve or disapprove the merger. Therefore, regulatory authority would not be impaired by virtue of the proposed disposition of facilities." Id. at 62,566-67.

In the instant case, the CPUC's otherwise applicable authority to review the transactions proposed in the Section 203 Application and the related November 30 Filings has been challenged by the applicant, PG&E, which seeks to preclude the exercise of the CPUC's authority. Accordingly, the CPUC must seek the assistance of FERC. Under the circumstances, FERC cannot assume that the CPUC will be free to exercise its otherwise applicable authority to review the transactions and address effects on competition, rates, and regulation. Accordingly, FERC's review of the proposed transactions must be particularly searching.

In addition to providing a full and fair evaluation of whether PG&E's proposals are in the public interest under the FPA, FERC can, and should, help to ensure that all of the public interest considerations at issue here are fully evaluated. Section 203(b) empowers FERC to issue orders authorizing disposition of jurisdictional property "upon such terms and conditions as it finds

necessary or appropriate to secure the maintenance of adequate service and the coordination in the public interest." In this matter, FERC should expressly condition any approvals it may issue herein on similar approval by the CPUC of transactions within the CPUC's jurisdiction pursuant to the California Public Utilities Code.

Finally, in addition to the three traditional factors addressed in any § 203 proceeding, FERC should in this matter consider several other factors which bear on whether the transactions proposed herein are in the public interest. Those factors are:
(1) the failure of consideration embodied in these transactions; (2) the environmental impacts of the proposed transactions; and (3) whether approval of this Application is consistent with PG&E's prompt emergence from bankruptcy.

B. Effect on Competition

The proposed transactions raise both vertical and horizontal market power issues. While arguing to the contrary, PG&E implicitly acknowledges as much—it places in a footnote the disclosure that its horizontal and vertical competitive screen analyses submitted with the Section 203 Application attribute 7,100 MW of generation facilities not to Gen, the proposed holder of those facilities in PG&E's brave new world, but to Reorganized PG&E. PG&E seeks to justify this treatment by asserting that the market power of Gen will be mitigated by the Purchase and Sales Agreement ("PSA") at issue in ER02-456-000. But, as PG&E surely realizes, the PSA is for twelve years, while the loss to PG&E of its hydroelectric and nuclear generating facilities under the Plan is forever. PG&E's competitive market screen analyses are invalid on their face, and cannot support PG&E's claims that the transactions will not have a detrimental effect on competition.[9]

[9] The CPUC will address the competitive market screen analyses in greater detail in discovery and testimony should this matter be set for hearing. See also the CPUC's contemporaneous filing in Docket No. ER02-456-000 (Gen).

As one of the largest holders of natural gas transportation assets, electric generation assets, and electric transmission assets in the western United States, PG&E's corporate parent will be in a prime position to exercise market power both vertically and horizontally. In the upstream delivered gas market, as in the SDG&E case, PG&E/GTrans would control access to the natural gas necessary for gas-fired generating companies which will compete with PG&E/Gen, and will have access to potentially sensitive market information regarding those competing generators' costs and fuel usage. SDG&E, 97 FERC at 62,562. And Gen, which will control 7,100 MW of generation (roughly 40% of the generation in the oft-constrained PG&E service territory), will clearly have market power in the California wholesale electric markets. See the CPUC's contemporaneous pleading in ER02-456 for a more detailed discussion of Gen's market power.

In addition, FERC has previously addressed this issue, and held that the sale and purchase of PG&E's generation in the wholesale market had a detrimental effect on competition. Accordingly, FERC ordered PG&E to use its retained generation resources—the same resources that it will "spin off" to its corporate parent in the proposed transactions—to serve its native load. San Diego Gas & Electric Company, et al., 93 FERC ¶ 61,294 (2000) at 62,001 (As a result of the order, "the IOUs will be able to provide power from their own resources to serve their own load . . . . The best way to mitigate cost exposure is for the IOUs to cease selling and repurchasing what they already produce").

C. Effect on Rates

The Merger Policy Statement explains that the protection of wholesale ratepayers and transmission customers is FERC's primary, but not sole, concern regarding the effects of a section 203 proposal on rates. Merger Policy Statement, at 30,123. Section 2.26 of FERC's regulations provides, under Effect on Rates, that "[a]pplicants should propose mechanisms to

protect customers from costs due to the [transaction]." The PG&E Plan will, by design, have a significant impact on both wholesale and retail electric rates. For instance, under the PSA proposed in Docket No. ER02-456-000, Gen will charge unjust and unreasonable wholesale rates to Reorganized PG&E, which proposes to pass the rates through to its retail ratepayers pursuant to the filed rate doctrine. Reorganized PG&E will be stuck with a long-term contract at above market rates. See the CPUC's contemporaneous pleading in ER02-456-000, incorporated herein by this reference, for a more detailed discussion of this issue. Retail ratepayers will be stuck paying passed-through wholesale rates approaching double the otherwise applicable retail rate for the same energy from the same power plants.

The "stable" rates which PG&E promotes as a virtue of its plan may have serious long term effects on California ratepayers and the California economy. These "stable" rates will result in overall retail rates over the next decade that rival those of the early 1990s, which engendered industrial users to begin the push for electric restructuring. Along with the above-market CDWR contracts against which the PSA is "benchmarked," these "stable" rates will threaten the state with recession as large users leave the state or decline to enter it. The "stable" above-market rates of the PSA thus threaten residential ratepayers with the prospect of paying an ever-increasing share of the "sunk" costs of the PSA.

Accepting as true for the purposes of argument PG&E's contention that its current wholesale customers will be protected from the costs of the transactions, Reorganized PG&E itself will be a new wholesale customer as a result of the transactions, and the purported cost protection provided to existing wholesale customers is noticeably not provided to Reorganized PG&E. To the contrary, Reorganized PG&E will be subject to the overpriced PSA, and as discussed in greater detail in the CPUC's contemporaneous pleading in Docket No. ER02-455

(ETrans), Reorganized PG&E will be saddled with the worst of PG&E's existing transmission contracts, while profitable contracts are transferred to ETrans. In addition, the high rates which Reorganized PG&E is committed to pay under the PSA detrimentally affect its ability to resume serving its "net short" load, and increases the likelihood of further retail rate increases in order for Reorganized PG&E to do so.

D. Effect on Regulation

PG&E's Plan and its implementation by means of the Section 203 Application would create very significant "regulatory gap[s] as a result of a corporate realignment," as well as "shifts of regulatory authority between the Commission and state commissions." Merger Policy Statement, at 30,124-25. Generally, federal regulation has primarily if not solely concerned wholesale rates, leaving the remaining bulk of regulation to the states. Gen. Motors Corp. v. Tracy, 519 U.S. 278, 290-92 (1997). The most significant of the regulatory gaps which would result if PG&E's Plan were accepted include: (1) the proposed creation of a new interstate pipeline with contractual obligations to customers and vendors, but which eliminates the obligation to serve California retail customers, and eliminates health, safety and welfare regulation over these facilities;[10] (2) the creation of new entities owning 7,100 MW of California generation facilities which would be entirely unregulated, either by the FERC or by the CPUC, and the attendant elimination of health, safety, and welfare regulation over these facilities; (3) the elimination of regulation and oversight over PG&E's Nuclear Decommissioning Trust Funds, resulting in the potential for underfunding in one or more of the trusts, and compromising the safety of PG&E's nuclear facilities.[11]

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[10] See the CPUC's contemporaneous pleading in Docket Nos. CP02-39-000 et al., incorporated herein by this reference, for a detailed discussion of this issue.

[11] See discussion, infra.

FERC has consistently held that the elimination of state regulation which proceeds from a proposed transaction constitutes a regulatory gap affecting the public interest. Merger Policy Statement, 77 FERC ¶ 61,263 (1996) ("commenters generally argue that it is important for the Commission to continue to look at the effect of a merger on the effectiveness of state and Federal regulation"); Enron Corporation, 78 FERC ¶ 61,179 (1997) (because "state and federal jurisdiction will remain static" pursuant to transaction, deferring action until after Oregon Commission has acted unnecessary); Niagara Mohawk Power Corporation, 89 FERC ¶ 61,124 (finding that "the proposed transaction will not adversely affect state regulation"); Niagara Mohawk Holdings, Inc., 95 FERC ¶61,381 (2001) ("we are also concerned with the effect on state regulation where a state does not have authority to act on a merger and has raised concerns about the effect on its regulation of the merged entity").

As the gas and nuclear issues are discussed extensively elsewhere (see footnotes 10 and 11), this section will focus on the regulatory gap with respect to PG&E's generating facilities. PG&E asserts that as a result of the proposed transactions the GenSub LLCs will not be public utilities under either state or federal law, and will thereby entirely unregulated. PG&E's claim that the GenSub LLCs will not be public utilities under federal law is addressed further infra. PG&E's contention that the GenSub LLCs will not be public utilities under state law apparently depends on the contention that by means of the proposed transactions the generating facilities—which will be used in the same manner that they have traditionally been used, if PG&E is to be believed, and to serve the same customers with the same energy—will no longer be dedicated to public use.[12] Currently, PG&E's generating facilities are subject to the full range of state rate,

[12] See Cal. Pub. Util. Code § 216; Richfield Oil Corp. v. Public Utilities Commission (1960) 54 Cal.2d 419, 426-31.

health, safety, welfare and reliability regulation. All safety and reliability regulation over the PG&E generating facilities would thus be lost if PG&E's Plan is implemented.

Furthermore, while Gen itself will be a public utility under federal law, under PG&E's Plan PG&E Gen would not be a public utility under state law. Accordingly there will be no regulatory body with health, safety, and welfare jurisdiction over the generating facilities. And while FERC would have a measure of regulatory authority over Gen's rates, the transformation from a vertical entity making retail sales to wholesale seller also entails a regulatory gap. The CPUC performs cost of service ratemaking, which FERC has held to be valuable in the December 15 order, while FERC generally does not.

Finally, although the CPUC would retain jurisdiction over the distribution facilities and retail rates of the resulting Reorganized PG&E, by wholly separating generation from load (promoted as another virtue of its Plan by PG&E), the Plan and this Section 203 Application would seriously undermine PG&E's ability to reliably serve its load, and wholly undermine the CPUC's ability to ensure that PG&E do so, at least in the short term.

E. The Failure of Consideration

PG&E's Section 203 Application is both incomplete for its failure to comply with Section 33.2(e)(3) of FERC's regulations, 18 C.F.R. § 33.2(e)(3), and, substantively, is not in the public interest because PG&E proposes to strip itself of its most valuable assets for insufficient consideration, to the detriment of both the resulting Reorganized PG&E and its ratepayers.

Section 33.2(e)(3) of FERC's regulations requires an applicant to discuss in a § 203 application "the consideration for the transaction." PG&E contends that "because this Transaction is not a sale of assets but rather a reorganization, the concept of consideration is not applicable." Application at 20. But PG&E provides no support for this contention, and FERC's regulations make no such exception. To the contrary, prior case law addressing transactions

related to bankruptcy reorganization have expressly addressed the consideration issue. See El Paso Electric Company, 68 FERC 61,181 (1994) at 61,893, 61,918. While PG&E has provided an Exhibit describing "the various financial transactions" associated with is Plan, PG&E fails to provide a narrative discussion of the transactions or their implications. For instance nowhere in PG&E's several thousand page filing does PG&E provide a single number indicating the value of the cash and notes to be provided to Reorganized PG&E as a result of the transactions.[13] PG&E's application is thus incomplete, and may be rejected on this basis alone.

An examination of the application reveals that the Section 203 Application and related Bankruptcy Court filings proposes transactions that fail to provide consideration to PG&E that can be considered in the public interest. The table below estimate the value of the assets to be transferred out of the PG&E utility under the Plan. No market valuation of the electric or gas transmission facilities have been made in Commission filings, but applying discounted cash flow valuation techniques and the plan's assumptions regarding net revenues to be derived from these assets, we obtain the following estimates:

[13] PG&E states that Gen will provide Reorganized PG&E with $2.4 billion in exchange for transfer of the generating facilities, and numbers for the amounts to be provided by GTrans and ETrans are provided separately, but no total figure is provided.

Comparison of Estimated Values of Transferred Assets and Consideration to PG&E
($ billion)

Type of Asset	Net Book Value	Market Value Estimate	Amount Returned to Utility by Mortgaging Assets[14]	Loss to Utility
Hydro Generation	0.59	2.8 – 4.1[16]		
Nuclear Generation	0.0	1.4[17]		
All Gen	0.59[15]	4.2 – 5.5	2.4	1.8 – 3.1
Electric Trans	1.5[18]	2.5[19]	1.05	1.45
Gas Trans	1.7[20]	1.5[19]	0.9	0.6
TOTALS	3.79	8.2 – 9.5	4.35	3.85 – 5.15

As these figures demonstrate, PG&E proposes to divest itself of its gas transportation, electric transmission, and electric generating facilities for amounts that approximate the book value of the facilities. Although the corporate parent proposes to capitalize the new entities based on the market value of the facilities, and charge market-based rates to Reorganized PG&E under the PSA, the proposed consideration to PG&E for the facilities approximates half of their

[14] PG&E Amended Disclosure Statement, Exhibit E., 12/19/01.

[15] PG&E 10-Q dated August 2, 2001 p. 25; value as of June 30, 2001.

[16] Market value of 2.8 fixed by settlement agreement between PG&E, TURN, and other parties in A.99-09-053. Market value of 4.1 estimated by PG&E in A.00-11-056, the rate stabilization proceeding.

[17] Based on an average price per kW for the recent sales of the Nine Mile Point Unit 2, Indian Point Unit 2, and Millstone Units 2 and 3.

[18] PG&E FERC Form 1, Vol. 1, 2000.

[19] "Market values" for electric and gas transmission are estimated using discounted cash flow analysis over 25 years of service at an assumed discount rate of 8%. Net income estimates from Attachment C of the 8-K issued with the Plan. Note that the value of the gas transmission assets derived from this method suggests that the value to investors is approximately the net book value of the assets.

[20] A.97-12-020 and PG&E FERC Form 1, Vol. 2, 2000.

market value, and results in a staggering loss to Reorganized PG&, on the order of $4 to $5 billion dollars.

Even this calculation, however, understates the loss to Reorganized PG&E. In addition to the gas transportation, electric transmission, and electric generating facilities, PG&E proposes to transfer to its parent tens of thousands of acres of watershed and forest land associated with its hydroelectric facilities which are not encompassed within the FERC-licensed projects (the "non-project hydro land"). This non-project hydro land is located primarily in the growing foothill regions of the Sierra Nevada, and will be subject to intense pressure for development (raising serious environmental concerns, as addressed in the CPUC's contemporaneous filing in the Section 8 applications, P-77-116 et al.). They are extremely valuable. Yet, apparently, Reorganized PG&E will receive nothing for the loss these lands, which will, in addition, be freed from CPUC regulation.

In addition, PG&E proposes to transfer its existing proprietary telecommunications network to ETrans or a subsidiary of ETrans called "Telco." See Application at 21; Exhibit I at I-4. The proposed transfer includes "related controls and intellectual property rights... used to transport voice and data information." Id. These assets probably include existing wire and fiber optic cables, rights of way, and wireless licenses. Such assets all hold the potential to become highly valuable on the open market; the licenses in particular my prove to be highly lucrative, as the radio band they use has recently been made commercially viable for cellular telephone service. PG&E's belief in the commercial value of its telecommunications assets is demonstrated e.g. in Pacific Gas & Electric Company, 90 FERC ¶ 61,314 (2000). Moreover, after the separation some of the telecommunications assets will then be leased back to Reorganized PG&E in whole or in part for profits at ratepayer expense.

On the other side of the ledger, the Section 203 Application proposes that Reorganized PG&E retain liabilities which logically would be transferred to ETrans. Reorganized PG&E is slated to hold the lion's share of PG&E's Existing Transmission Contracts ("ETCs"), and the ETCs assigned to Reorganized PG&E will be the most underperforming of the lot – including WAPA Contract 2948A, which PG&E has elsewhere alleged will cost PG&E on the order of $1.8 billion before its 2004 termination.[21] The ETC allocation proposed in the Section 203 application, and the related "Back-to-Back agreement" proposed in Docket No. ER02-455-000 simply facilitate PG&E Corp.'s culling of the transmission wheat from the chaff, with the chaff falling to Reorganized PG&E while ETrans makes off with the wheat.

Ratepayers have funded, through the ongoing recovery in rates, depreciation, etc, under the benefits of monopoly regulation, the acquisition and construction of all of these assets. It fundamentally contravenes the public interest for PG&E to transfer these assets to its to-be-unregulated corporate parent without assuring that ratepayers receive fair value in return, whether the transaction is proposed in the context of a Bankruptcy reorganization plan or in any other context. This Plan most assuredly does not provide ratepayers, or Reorganized PG&E, with fair consideration, and the Plan must be rejected as contrary to the public interest.

F. NEPA Review is Required for the November 30 Filings

Adequate protection of the public interest requires FERC to conduct environmental review of the proposed hydroelectric project license transfers, and the related transfers proposed herein, under the National Environmental Policy Act ("NEPA") 42 U.S.C. Section 4332(2)(C).[22]

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[21] See letter dated March 27, 2001 to the FERC in Pacific Gas and Electric Company, FERC Docket ER01-1639-000, in which PG&E sought to amend, inter alia, Contract No. 2948A.

[22] Environmental issues are discussed in greater detail in the CPUC's "Motion To Dismiss, Or In The Alternative, Protest, Request For Consolidation And Request For Hearing Of The Public Utilities Commission Of The State Of California", Project Nos. 77-116 et al. ("the Section 8 protest"), filed contemporaneously, protesting PG&E's Section 8 Applications which seek the transfer of PG&E's twenty six hydroelectric project FERC licenses to newly

Although FERC regulations typically exclude from NEPA review applications under Sections 8, 203, 204, and 205 (18 C.F.R. Section 380.4(a)(15)& (16)), NEPA review is specifically warranted here by special circumstances recognized under 18 C.F.R. § 380.4(b)(2), and 40 C.F.R. § 1508.4.

Underlying the CPUC's contention that FERC should undertake NEPA review related to PG&E's Section 8 Applications is a Draft Environmental Impact Report (DEIR) prepared by the CPUC pursuant to the California Environmental Quality Act, Cal. Pub. Res. Code Sections 21000 et seq., in conjunction with PG&E's 1998 application before the CPUC to sell all of its hydroelectric assets and associated lands. While the DEIR reaches conclusions specific to transfer scenarios involving the hydroelectric projects, the CPUC's Section 8 protest notes the relationship between the Section 8 and Section 203, 204 and 205 applications which similarly warrant NEPA consideration.

The transactions contemplated in connection with the Section 203, 204, 205,and 8 applications at issue here are not typical or simple ownership transfers. Instead, the changes in ownership contemplated by, or inextricably intertwined with, these applications are massive, and it is reasonably foreseeable that these proposed transactions will have significant environmental consequences.

The separate applications in the November 30 Filings deal with separate but interrelated transactions, all of which are portions of a single overarching Plan of Reorganization. FERC is required to address them together in assessing the need for NEPA review. CEQ regulations provide that in preparing an EIS, all connected actions should be considered in one document. 40 C.F.R. § 1508.25. Actions are considered connected if they "cannot or will not proceed

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formed individual Limited Liability Company's ("LLCs"), and the subsequent lease of project properties to the newly formed LLC's' parent company, GEN. The CPUC incorporates the Section 8 protest herein by this reference.

unless other actions are taken previously or simultaneously" or are "independent parts of a larger action and depend on the larger action for their justification." Id. Under this standard, that PG&E's Section 8 applications, and indeed all of the November 30 Filings, are all connected for the purpose of NEPA review is beyond dispute. CEQ regulations further provide that in determining the significance of an action, "significance cannot be avoided by . . . breaking [an action] down into small component parts." 40 C.F.R. Section 1508.27(b)(7). See also Blue Mountains Biodiversity Project v. Blackwood, 161, F.3d 1208 (9th Cir. 1998) (Forest service was required to prepare single EIS that addressed cumulative effects of five salvage logging projects proposed for same watershed.)

In view of the above-stated considerations, the transfers proposed by PG&E in its Section 203 Application warrant and must be considered in the context of NEPA evaluation by the FERC.

G. Emergence From Bankruptcy

PG&E contends that its prompt emergence from bankruptcy is in the public interest. With this the CPUC agrees. This principle does not, however, support PG&E's request for hasty approval of the Section 203 Application. The Section 203 Application will not facilitate PG&E's prompt emergence from bankruptcy, since it attempts to implement a plan that, even if confirmed by the Bankruptcy Court, will inevitably be but the first step in lengthy litigation. To the contrary, the most likely means to PG&E's prompt emergence from bankruptcy, and restoration to creditworthiness, is embodied in the CPUC's proposed Alternative Plan. As discussed above, the CPUC will provide additional information to the Bankruptcy Court regarding the Alternative Plan on February 13, 2002, after which the Bankruptcy Court will determine whether to permit the filing of the Alternative Plan.

While emergence from bankruptcy is clearly in the public interest, PG&E's Plan is not. The Plan is simply too costly, in every sense of the word. It is too costly to PG&E's ratepayers, who will pay close to double the otherwise applicable rates under the PSA for the same energy from the same plants. See the CPUC's contemporaneous pleading in ER02-456-000 (Gen). It is too costly to Reorganized PG&E, stripped of its most valuable assets but saddled with liabilities its parent no longer wants. See the CPUC's contemporaneous pleading in ER02-455-000 (ETrans). It is too costly to the State of California, which would be stripped of basic tools necessary to protect the public health safety and welfare of its citizens (and potentially bereft of funds necessary to ensure the safe decommissioning of two nuclear power facilities).

Haste in these proceedings, then, will not facilitate PG&E's prompt emergence from bankruptcy. For that, PG&E will be required to work with the state, rather than continuing to work against it.

VII. THE REQUEST FOR AUTHORIZATION TO TRANSFER NUCLEAR DECOMMISSIONING TRUST FUNDS MAY NOT LAWFULLY BE APPROVED BY FERC

PG&E's request that FERC authorize the assignment of 100% of its beneficial interest in those portions of the CPUC Qualified and Nonqualified Nuclear Decommissioning Trusts (the "Trusts") "associated with" the Diablo Canyon Power Plant ("DCPP") to Diablo Canyon LLC cannot lawfully be approved by FERC. FERC should reject this request for the following reasons, each of which is discussed more fully below: (1) FERC does not have jurisdiction over these Trusts and accordingly cannot authorize their assignment; (2) to the extent that there is any FERC jurisdiction over the Trusts, the proposed assignment cannot be accomplished without approval of the CPUC; (3) to the extent that there is any FERC jurisdiction over the Trusts, it would be unjust and unreasonable to the California ratepayers who have funded these Trusts to authorize their assignment to a holding company that has no explicit obligation to those

ratepayers and that could loot or exploit the Trusts' assets to its own advantage, and to the ratepayers' disadvantage; and (4) to the extent that there is any FERC jurisdiction over the Trusts, the Trusts provide funds for the eventual decommissioning of other PG&E assets—specifically, Humboldt Bay Nuclear Unit No. 3 ("HB-3")—which will be retained by PG&E, as well as for the eventual decommissioning of DCPP; thus, on purely practical grounds, the proposed assignment will create serious difficulties and potential inequities in terms of allocating the Trusts' assets as between the needs of DCPP and those other assets.

A. FERC Lacks Jurisdiction to Authorize Any Assignment of PG&E's Interests in the Trusts

Because the Trusts are not FERC-jurisdictional agreements, FERC has no authority to approve the transfer proposed by PG&E. PG&E asserts that the Trusts "consist of both CPUC jurisdictional and FERC jurisdictional trusts." However, PG&E provides no support for this assertion, either by reference to the Trusts themselves or in any other manner. To the contrary, PG&E apparently acknowledges the lack of FERC jurisdiction over the proposed transfer, stating that "[t]o the extent the Commisison may deem the transfer of such beneficial interest to be jurisdictional, Applicants are seeking Commission approval . . . ." Application at 73. The Trusts were developed in a vertically integrated environment in which PG&E's nuclear facilities provided energy at retail to California consumers, under CPUC regulation. The Trusts themselves provide that they were established pursuant to the regulatory authority of the CPUC and the Nuclear Regulatory Commission ("NRC"). See also Cal. Pub. Util. Code §§ 8321 – 8330 (California Nuclear Decommissioning Act of 1985). The Trusts are not "facilities subject to the jurisdiction of the Commission" to which § 203 has any application. Cf. Enova Corp. and Pacific Enterprises, 79 FERC ¶ 61,107 (1997) at p. 61,489; Conoco, Inc. v. FERC, 90 F.3d 536

(D.C. Cir. 1996). Rather, any disposition of the Trusts must be pursuant to CPUC order, and to the extent applicable, NRC order.

PG&E claims that FERC authorization of the assignment of PG&E's beneficial interests in the portions of the Trusts associated with DCPP is "an essential element of the Transaction because it is necessary to permit Diablo Canyon LLC to become the owner of DCPP under the AEA [Atomic Energy Act, 42 USC § 2011 et seq.] and the NRC's implementing regulations . . . ." Application at 74. PG&E is correct, of course, that the assignment of the DCPP portion (whatever that is) of PG&E's interests in the Trusts may be necessary under the Atomic Energy Act and NRC regulations to effectuate the transfer of DCPP to Diablo Canyon LLC, but FERC certainly does not have the authority to enforce the Atomic Energy Act or the NRC's regulations. Nor does FERC have authority to "authorize" the assignment of PG&E's interests in the DCPP portion of these trusts to Diablo Canyon LLC or to any other entity.

This is true regardless of any order the Bankruptcy Court may or may not issue. In a footnote, PG&E indicates that it will ask the Bankruptcy Court to "compel" the CPUC to approve the transfer or to "deem" the approval to have been granted by the CPUC. Application at 74, n.57. However, the funds contained in the Trust are not subject to creditors' claims (except, of course, for claims relating to decommissioning activities for which a proper Disbursement Certificate is submitted to the Trustee)[23] and are therefore outside the purview of the Bankruptcy Court. The Bankruptcy Court therefore has no authority to "break" the contact as part of its approval of a reorganization plan. See In re Nitec Paper Corp. 43 B.R. 492 (S.D.N.Y. 1984) (district court reversed order of Bankruptcy Court permitting the debtor to assign a contract in violation of both state and federal law). In any event, even if the Bankruptcy

[23] See discussion infra.

Court may or indeed does issue an order of the type contemplated by the PG&E footnote, such an order would in no way increase FERC's jurisdiction, or change the non-jurisdictional status of the Master Trust Agreements. Accordingly, this portion of the Section 203 Application must be dismissed for lack of jurisdiction.

B. No Transfer of the Trusts May Be Accomplished Without the Approval of the CPUC

The Master Trust Agreements that govern the management of the Trusts are contracts between the CPUC, PG&E and the Trustee, Mellon Bank, N.A. The Master Trust Agreements are, by their terms, irrevocable and not transferable. Section 2.07 of the Master Trust Agreement for the Qualified Decommissioning Trust (the larger of the two in terms of asset value) provides as follows:

> "The interest of the Company [PG&E] in the Master Trust is not transferable by the company, whether voluntarily or involuntarily, nor subject to the claims of the creditors of the Company, provided, however, that any creditor of the Company as to which a Disbursement Certificate has been properly completed and submitted to the Trustee may assert a claim directly against the Master Trust in an amount not to exceed the amount specified on such Disbursement Certificate. Nothing herein shall be construed to prohibit a transfer of the Company's interest in the Master Trust upon sale of all or part of the Company's ownership interest in any Plant or Plant's; provided, however, that any such transfer shall be subject to the prior approval of the CPUC."

Section 2.06 of the Master Trust Agreement for the Qualified Decommissioning Trust sets forth identical language.

This Master Trust Agreements thus explicitly deny PG&E the authority to transfer its interest in the Trusts either voluntarily or involuntarily. The only exception is in connection with a sale of PG&E's ownership interest in the plant. However, in such a case, the Master Trust Agreement specifically provides that "any such transfer shall be subject to the prior approval of the CPUC." Thus, PG&E's effort via the Section 203 filing to request FERC to assign its interests in the Trusts to Diablo Canyon LLC, without first seeking the approval of the CPUC on

its face violates the terms of its contractual agreement and is accordingly a void and unlawful act.

Ultimately, PG&E's request that FERC "authorize" its assignment of its DCPP-related interests in the Trusts to Diablo Canyon LLCF is an idle and futile exercise. The one leading authority cited in section V of its Application, which deals with this issue, Niagara Mohawk Power Corp., 89 FERC ¶ 61,124 (1999) in no way supports PG&E's "authorization" request with respect to assignment of PG&E's DCPP-related interests in the Master Trust Agreements. Indeed, if anything, the Niagara Mohawk decision undermines the basis for PG&E's request.

In Niagara Mohawk, the co-tenants of the proposed transferee of a majority interest in the Nine Mile Point II power plant protested the proposed transfer based on concerns that the proposed transferor might have insufficient funds to meet its portion of eventual decommissioning expenses, and complained in this regard that the transferor failed to seek FERC approval for the transfer of nuclear decommissioning funds. In its decision, the Commission found that there was no need to separately address whether such authorization was needed in that case, and noted that the financial ability of the proposed transferee to fund nuclear decommissioning was a matter to be addressed in an NRC proceeding. Moreover, in Niagara Mohawk, the Commission explicitly recognized that the proposed transaction was "subject to review by the New York State Commission, and no state commission has argued that the proposed transaction would impair state regulation." See 89 FERC, at 61,347. Thus, PG&E's citation to this Commission decision attempts to turn the plain language of the decision inside out. PG&E is attempting to use a finding that holds that the specific authorization of the transfer of decommissioning funds is a matter, not requiring specific FERC approval, for other agencies

(the NRC and presumably also the state) to decide into a pretext for de facto preemption of the state's clear contractual right to make that policy judgment.

C. Assignment of the Trusts' Assets Would Not Be in the Public Interest

PG&E contends, without any evidentiary support or analysis, that the assignment of its beneficial interests in the portions of the Trusts associated with DCPP "is consistent with the public interest and is in the public interest." Application at 74. In fact, the opposite is closer to the truth. For instance, the U.S. General Accounting office has just released a report (GAO-02-048, January 2002) finding that the NRC has been approving licensing transfers and related decommissioning efforts even though new owners and operators are unable to assure regulators that the money for decommissioning will be there when reactors are ready for burial.

The specific question of whether the transfer of a nuclear decommissioning fund would be in the public interest, was examined in detail by the CPUC several years ago in a case, A.97-12-039, involving the application of San Diego Gas and Electric Company (SDG&E) for authority to sell its share of the San Onofre Nuclear Generating Station ("SONGS"). There, even SDG&E's partner in SONGS, Southern California Edison Co. ("Edison") expressed concern regarding the proposed transfer, questioning how ratepayers can be assured of protection if the decommissioning trust fund is dissipated by the new, non-utility owner after the transfer. (See RT of October 21, 1999 hearing in CPUC Docket A-97-12-039, at 22.) That question, an answer to which is not even suggested by PG&E in its voluminous Section 203 filing, is as cogent today in the context of the transfer that PG&E is requesting the Commission to authorize as it was 2½ years ago in that SONGS proceeding. On November 5, 1999, SDG&E withdrew its request to divest its interest in SONGS. See In the Matter of the Application of San Diego Gas & Electric Company (U-902-E) for Authority to Sell Electrical Generation Facilities et al., D.00-10-054, 2000 Cal. PUC LEXIS 760 (2000).

It should also be noted that California's decommissioning law is stricter than required by the NRC. Pursuant to the California Nuclear Facility Decommissioning Act of 1985 (Pub. Util. Code sections 8321 through 8330), California's nuclear power plants generally have considerably more money in the decommissioning trust funds than in most other states, which typically comply only with NRC rules. Under this law, not only must more money be put into such funds (the maximum contribution allowed pursuant to section 468A of the U.S. Internal Revenue Code, and applicable regulations adopted pursuant thereto), but also California has the oversight authority to make sure that the decommissioning work gets done in a timely fashion. Under CPUC oversight, to date, PG&E has been a good steward of the Trusts.

However, there is absolutely no guarantee that a Diablo Canyon LLC or some other entity that is not regulated by the CPUC would maintain that stewardship, and yet, the transfer of PG&E's "beneficial interest" in the portions of the Trusts associated with DCPP will effectively put much of the Trusts assets in the hands of such a less reliable and less trustworthy entity, over which, in PG&E's view, neither FERC nor the CPUC would have regulatory authority. Such an unregulated entity would have the incentive to delay performing the decommissioning as long as possible, in order to make as much money for itself, using ratepayer provided funds. It would not be in the public interest, and it would be unjust and unreasonable to PG&E's ratepayers, who have footed the bill for the eventual decommissioning of DCPP, to allow such a situation to arise.

D. The Impracticality of Assigning the Trusts' Assets

Based on information contained in the most recent annual report (for calendar year 2000) from PG&E's Nuclear Facilities Decommissioning Master Trust Committee ("NFDMTC"), there is currently a total of some $1.462 billion of assets in the Trusts. It is important to note, however, that the Trusts are intended to cover decommissioning costs for the shut down of <u>both</u>

HB-3 and the DCPP units. By their terms, the Trust documents do not allocate any given amount of the funds controlled by the Trusts to either plant.

PG&E attempts to sweep this serious problem under the rug by blithely asserting in a footnote (at App. 73 n.56) that all of the funds in the Trusts associated with HB-3will be "segregated" from the DCPP components of the Trusts as part of the larger transaction that PG&E is requesting the Commission to approve. Unfortunately, nothing in PG&E's Section 203 filing indicates how this "segregation" will take place. Nor does PG&E explain how such a "segregation" is consistent with, or permitted by, the Trust documents.

Even if it is both lawful and achievable to so segregate the Trust funds, given the unpredictable nature of decommissioning activities, it would be unreasonable and impractical to attempt to allocate the Trusts into separate HB-3 and DCPP components without a detailed study of the likely scope of the decommissioning effort required for each facility. Such a study would be a lengthy, complicated and expensive endeavor. However, without a proper allocation of Trust assets to HB-3 and DCPP based on a prudent and thorough analysis of the likely costs of decommissioning for both facilities, there is a significant likelihood that one or the other of the facilities would have too little funds to properly complete decommissioning, thereby resulting, especially in the case of HB-3, in an unnecessary, unjust and unreasonable adverse impact on PG&E's ratepayers, and potential health safety and welfare concerns for California citizens. Thus, assuming arguendo that FERC had the authority to divide the corpus of the Trusts and to assign some share of the Trusts' assets that would be allocated to DCPP to Diablo Canyon LLC (which, as we point out above, FERC clearly does not have the authority to do), it would be improper, imprudent and impractical for the Commission to do so absent the results of a detailed study which has not yet even been commenced.

VIII. THE PLAN VIOLATES SECTION 305 OF THE FEDERAL POWER ACT

The Spin-Off transactions proposed in the instant application (the "Spin-Off") violate § 305 of the FPA.[24] Accordingly, FERC cannot lawfully approve the Spin-Off, and the application should be summarily rejected. Section 305(a) provides:

> It shall be unlawful for any officer or director of any public utility to receive for his own benefit, directly or indirectly, any money or thing of value in respect of the negotiation, hypothecation, or sale by such public utility of any security issued or to be issued by such public utility, or to share in any of the proceeds thereof, or to participate in the making or paying of any dividends of such public utility from any funds properly included in capital account.

The last clause of § 305(a) prohibits the payments of dividends by public utilities (and § 12 prohibits such dividends by natural gas companies) from any funds properly included in a capital account. There are two elements to the unlawful act: (1) payment of dividends; and (2) from funds properly included in a capital account. PG&E concedes that the Spin-Off satisfies both elements, and thus that its proposal violates sections 305 and 12. PG&E concedes that the Spin-Off includes the payment of dividends. See Application at 75 ("These dividends consist of . . ."). PG&E further concedes that the proposed dividends "must necessarily be deemed to be from a capital account." Application at 80.

Despite conceding that its proposal violates these strictures of the FPA, PG&E argues that FERC should not enforce the law against PG&E because the Congress did not mean what it said. Such a position cannot be countenanced. A federal agency does not have the luxury of ignoring the plain language of a federal statute. Circuit City Stores Inc. v. Adams, 532 U.S. 105 (2001). The "plain" in "plain meaning" means that a court looks to the actual language used in a

[24] In addition, to the extent that PG&E is or becomes a natural gas company as a result of its applications in CP02-39-000 et al. thus making section 12 applicable to the Spin-Off, the Spin-Off violates section 12 for the same reasons as set forth in the text. As PG&E acknowledges, § 305 of the FPA and § 12 of the NGA are virtually identical. See Inexco Oil Co., 17 FERC ¶ 61,310 at 61,610 (1981). See also the CPUC's contemporaneous filing in Docket Nos. CP02-39-000 et al.

statute, not to the circumstances that gave rise to that language. CBS Inc. v. Primetime 24 Joint Venture, 245 F. 3d 1217 (11th Cir. 2001) If the meaning of the rule is perfectly plain from its language, that ends the inquiry. United States v. Alvarez-Sanchez, 511 U.S. 350, 356 (1994) ("When interpreting a statute, we look first and foremost to its text"); see also United States v. Ron Pair Enterprises, Inc.,489 U.S. 235, 241-243 (1989; United States v. Bost, 87 F. 3d 1333, 1335 (D.C. Cir. 1996); Harbor Gateway Commercial Property Owners' Association v. United States EPA, 167 F. 3d 602, 606 (D.C. Cir. 1999).

PG&E argues, for instance, that the "intent" of § 305 was to prevent the failure to clearly identify the sources from which dividends were paid, and to prevent the payments of "excessive" dividends by holding companies on the securities of their operating companies. Application at 79. Whatever the merits of these assertions, what is clear is that that is not what the statute says. Both sections 305 and section 12 of the NGA are clear and unambiguous on their face. The Congress prohibited the payment of dividends from funds properly included in any capital account. It is neither necessary nor permissible for courts, or in this case, FERC, to look behind the plain language of such a statute to discern a purportedly more relaxed "intent." The Supreme Court has made it clear that "given [a] straightforward statutory command, there is no reason to resort to legislative history." United States v. Gonzales, 520 U.S. 1,6 (1997); accord Circuit City Stores Inc. v. Adams, 532 U.S. 105 (2001); CBS Inc. v. Primetime 24 Joint Venture, 245 F. 3d 1217 (11th Cir. 2001); Pair, supra, 489 U.S. at 241 ("where, as here, the statute's language is plain, 'the sole function of the courts is to enforce it according to its terms'"). Where there exists "straightforward language [the court] cannot read the lack of specific legislative history confirming one possible application of a single provision in an enormous statutory structure to signify Congressional intent to exclude such an application." Blue Cross and Blue Shield of

Alabama v. Weitz, 913 F.2d 1544, 1549 (11th Cir. 1990). The reason is that "it is ultimately the provisions of our laws rather than the principal concerns of our legislators by which we are governed." Oncale v. Sundowner Offshore Servs., Inc., 523 U.S. 75, 79 (1998).

Here, the statutory language is unambiguous, and PG&E does not contend otherwise. The statute prohibits public utilities from paying "any" dividends from funds (not solely cash dividends) properly included in capital accounts. This ends the inquiry. While the legislative history discussed in the application provides examples of abuses which § 305 may have been intended to address, that legislative history is entirely consistent with enforcement of the plain language of the statute, and can by no means "signify Congressional intent to exclude" enforcement of the plain language of the statute. Blue Cross and Blue Shield of Alabama v. Weitz, 913 F.2d 1544, 1549 (11th Cir. 1990).

Prior FERC case law is of no assistance to PG&E. To the extent that such cases in fact decline to enforce the plain meaning of § 305 against filing utilities, they are wrongly decided, and should not be followed here. The CPUC is aware of no court case which has affirmed a FERC decision declining to enforce § 305. Even on their face, however, the cases cited by PG&E are distinguishable on their facts.

In Citizens Util. Co., 84 FERC ¶ 61,158 (1998) FERC approved a proposal to separate Citizens' communications business from its utility business. A stock dividend was involved. Importantly, no intervenor challenged either the proposed transaction or the method by which Citizens proposed to accomplish the transaction.[25] Citizens' asserted that: (1) it was not proposing to make a dividend from funds properly included in a capital account; (2) it had

[25] The Vermont Department of Public Service filed a protest "urg[ing] the Commission not to approve the transaction unless it is clear that utility ratepayers would not be disadvantaged," but did "not object to the spin-off per se." Id.

"accumulated sufficient undistributed earnings in its Proprietary Capital accounts, to support the proposed distribution;" and (3) "the proposed separation does not involve any of the financial abuses that section 305(a) was intended to prevent, i.e., misleading shareholders or raiding the company's earnings for the benefit of a holding company." FERC examined the legislative history of § 305, and concluded that none of the problems that reportedly led to the enactment of § 305 were present in that case.

Here, by contrast, none of the critical factual predicates which Citizens established are present. To the contrary, the problems which FERC concluded in Citizens had led to the enactment of § 305 are clearly present here. PG&E concedes that its proposed dividend is from a capital account. Application at 80. PG&E further concedes that it has "no retained earnings from which to 'pay' a dividend." Application at 80. Furthermore, this case does involve "raiding" the company's assets for the benefit of the holding company. PG&E's Plan of Reorganization, of which its corporate parent PG&E Corporation is a co-sponsor, and which would be implemented in part by the proposed Spin-Off, proposes to transfer critical utility assets to the holding company for a fraction of their value. See discussion, supra. Unlike Citizens, in which there was "nothing to indicate, and Vermont DPS has not alleged, that any dividends paid will be excessive," in this matter it is clear beyond dispute that the proposed "dividend" will far exceeds the value which Reorganized PG&E will receive in return, and are excessive as a matter of law. See also Delmarva Power & Light, 91 FERC ¶ 61,043 (2000). In Delmarva, FERC approved a similar transaction, but expressly limited its approval to "the circumstances of this case." Id. No party protested the application or even sought to intervene. FERC found that the proposed dividend was not excessive.

Nor is Public Service of New Mexico, 93 FERC 61,213 (2000) of any help to PG&E. In PSNM, "a corporate separation [was] being performed to comply with a requirement of state law." No party protested the application. Here, by contrast, PG&E proposes the Spin-Off in direct defiance of, among other things: (1) state law prohibiting the disposition of utility-owned generation assets prior to 2006; (2) long-standing CPUC regulation (which has the force of law) prohibiting PG&E from taking action which would alter the jurisdictional status of its natural gas transmission and storage systems; and (3) state law requiring CPUC approval in the public interest of any proposed disposition of utility assets.

In what is apparently the only prior case in which the applicants' proposed interpretation of § 305 was challenged by intervenors, FERC refused to grant the application as proposed. In Niagara Mohawk Holdings, Inc., 95 FERC 61, 381 (2001) rejected applicants proposal which would not have "limit[ed] dividend payments to just the balance of retained earnings that will be transferred to capital accounts." Id. FERC's concern was premised on its conclusion that "dividends could exceed the balance in the retained earnings account." Id. FERC conditionally approved the proposal, but required applicants to make a compliance filing limiting the payment of dividends to the amount of retained earnings. Id. In PG&E's case there are no retained earnings at all.

IX. THE REQUEST FOR DISCLAIMER OF JURISDICTION OVER THE GENERATION LLCS SHOULD BE DENIED, AS THEY DO NOT QUALIFY FOR PASSIVE INVESTOR STATUS

PG&E's attempt to avoid FERC public utility status under § 201 for the GenSub LLCs must be denied. As structured by PG&E, the relationship between Gen and the GenSub LLCs, fits no fact pattern under which FERC has disclaimed jurisdiction. Here, it is proposed that the GenSub LLCs own the hydro facilities, and hold the licenses.. It is proposed that Gen "lease" the facilities—from subsidiaries Gen controls—and operate the facilities. PG&E cites no case where

FERC disclaimed jurisdiction under § 201 of the FPA of a wholly owned subsidiary acting as a passive investor/lessor that holds (1) Part I licenses for Projects, and (2) holds title to the generation facilities. FERC has disclaimed jurisdiction in cases where an LLC was created solely for the purpose of holding property, but not where the LLC held both the property and Part I licenses.

A request for disclaimer of FERC jurisdiction over entities taking title to jurisdictional facilities by way of sale and leaseback transaction was addressed in Pacific Power and Light Company. 3 FERC ¶ 61,119 (1978).[26] In Pacific Power, the Commission established a two-step analysis for determining whether holding a financial interest in jurisdictional facilities constitutes ownership resulting in public utility status under the FPA. See Allegheny Energy Supply Company, LLC, 97 FERC ¶ 61,377 (2001); City of Vidalia, 52 FERC P61,199 (1990). Under that analysis, FERC must determine first whether the purported "passive participants" will operate the facilities. Second, FERC must be assured that a "passive participant" is not in the business of producing or selling electric power. In Pacific Power, FERC concluded that because the passive participant held mere equitable or legal title to the subject electric facilities and were clearly removed from the actual operation of the facilities and the sale of power, the passive participants were not public utilities for the purpose of § 201(e) of the FPA. See Pacific Power, at 61,377.

PG&E's GenSub LLCs fail both prongs of the Pacific Power test. First, each of the GenSub LLCs is to be controlled entirely by Gen. As to each of the GenSub LLCs, Gen is the "sole member" of the LLC. PG&E concedes that Gen will be a public utility under federal law.

[26] There, the Commission granted a request for waiver of jurisdiction over financial institutions which took title to facilities as part of a leveraged lease transaction. The Commission found that the titleholders: (1) would not operate or control the operation of the jurisdictional facilities and (2) were not otherwise engaged in the business of selling or producing electric power, and that their principal place of business activity was other than that of a public utility.

The GenSub LLCs are no more than sham paper entities, entirely controlled by a public utility. Effectively, Gen is the GenSub LLCs. Moreover, the lease agreements between Gen and each of the GenSub LLCs contain a "savings provisions" entitling the GenSub LLCs to take action at any time to assure compliance with FERC license conditions. Application at 83.[27] Thus, it cannot be said that the purportedly passive participant is sufficiently remote from the operation or control of the facilities to meet the Pacific Power standard.

PG&E fails the second prong of the Pacific Power test as well, as the GenSub LLCs cannot be said to be "not in the business of producing or selling electric power." PG&E's reliance on Green Mountain Power Corp., 53 FERC ¶ 61,035 (1990) is misplaced. In Green Mcuntain, the "passive investor" was IBM. IBM was not in charge of operating or controlling the facilities and was not in the business of selling or producing power. See Pacific Power, 3 FERC at 61,337. Unlike IBM, which has a large and well known business unrelated to electric generation, the GenSub LLCs have no other business and no other purpose. Nor are the GenSub LLCs a bank which happens to have an ownership interest in a power plant. Moreover, the GenSub LLCs relationship to the facilities is not limited to "mere equitable or legal title to the subject electric facilities" nor are the GenSub LLC's "clearly removed from the actual operation of the facilities and the sale of power," since the GenSub LLCs will also hold the FPA Part I licenses. Gulf States Util. Co., 54 FERC ¶ 61,826 (1991), also relied on by PG&E, is similarly distinguishable on its facts.

Because the proposal fails both prongs of the Pacific Power test, PG&E's request for a disclaimer of jurisdiction over the GenSub LLCs should be denied. However, if FERC were to

[27] Moreover, PG&E takes an inconsistent position in the Section 8 Applications, asserting that the lease agreements proposed therein should be approved because the "savings provision" gives the licensee sufficient control over operations to qualify as a licensee. See, e.g., Sec. 8 App. for P-2687 at 10.

disclaim jurisdiction over the LLCs, it should require that Gen be made a co-licensee of each applicable project.[28]

X. CONCLUSION

For the foregoing reasons, the CPUC submits that the Section 203 Application should be summarily rejected in its entirety. The proposal is inconsistent with the public interest. Moreover, even if the proposals could be considered in the public interest, critical portions of the proposed transactions—such as the proposed dividend discussed above—simply violate federal law, rendering the entire proposal infirm. Finally, if the Section 203 Application is not dismissed, PG&E's package of November 30 Filings intended to implement (or such of the proceedings which survive dismissal) should be consolidated and set for hearing.

Respectfully submitted,

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January 29, 2002

[28] See the CPUC's contemporaneously filed pleading in the Section 8 proceeding, P-77-116 et al. That FERC require the LLCs and Gen to be co-licensees is consistent with City of Vidalia, 52 FERC ¶ 61,199 (1990) and Oglethorpe Power Corp., 77 FERC ¶ 61,334 (1996), where both the "passive investors" and the lessees were co-licensees.

CERTIFICATE OF SERVICE

I hereby certify that I have this day caused the foregoing document to be served upon all known parties in this proceeding by mailing by first-class mail a copy thereof properly addressed to each such party.

Dated at San Francisco, California, this 29th day of January, 2002.

Sean Gallagher

EXHIBIT E

UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

Pacific Gas and Electric Company, PG&E Corporation On Behalf of its Subsidiaries Electric Generation LLC, ETrans LLC and GTrans LLC	Docket No. ES02-17-000

MOTION TO DISMISS, OR, IN THE ALTERNATIVE, PROTEST AND REQUEST FOR HEARING, AND COMMENTS OF THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Pursuant to Rules 211, 212 and 217 of the Rules of Practice and Procedure ("Rules") of the Federal Energy Regulatory Commission ("FERC"), the Public Utilities Commission of the State of California ("CPUC") hereby moves to dismiss the application for lack of jurisdiction. In the alternative, if the application is not dismissed, the CPUC protests the filing made in the above-referenced docket, provides comments, and requests that FERC set the matter for hearing.

The CPUC is a constitutionally-established agency charged with the responsibility for regulating natural gas and electric corporations within the State of California. In addition, the CPUC has a statutory mandate to represent the interests of natural gas and electric consumers throughout California in proceedings before the Commission. The CPUC previously filed a Notice of Intervention in these proceedings on December 14, 2001.

I. THE SECTION 204 APPLICATION

On November 30, 2001, Pacific Gas and Electric Company ("PG&E") and PG&E Corporation ("Parent"), on behalf of its subsidiaries, ETrans LLC ("ETrans") and Electric Generation LLC ("Gen") (collectively, the "Applicants"), tendered a filing in the above-referenced docket, seeking authorization under Section 204 of the Federal Power Act ("FPA") to issue a variety of securities and assume a variety of liabilities, and for a waiver of the Commission's competitive bidding and placement regulations. PG&E is a debtor pursuant to Title 11 of the U.S. Code. Applicants state that this filing has been filed in connection with PG&E's proposed "Plan of Reorganization under Chapter 11 of the Bankruptcy Code for Pacific Gas and Electric Company" ("Plan") jointly filed by PG&E and its Parent with the Bankruptcy Court on September 20, 2001. PG&E states in its application that it does not expect to seek approval of the Transaction by the CPUC.

On December 12, 2001, the FERC issued its "Notice of Filing," setting until January 30, 2002, for the filing of interventions and protests in these dockets. The filing of the Section 204 Application is one part of a complex series of filings ("November 30 Filings") made by PG&E before the FERC as part of the implementation of PG&E's Plan. These filings are voluminous in nature—by PG&E's estimate, 20,000 pages.

The Plan was jointly filed by PG&E and its Parent with the Bankruptcy Court on September 20, 2001. PG&E's Plan involves a complex disaggregation of various businesses within PG&E and the spin-off of its distribution business to a Reorganized PG&E, which will be a separate company that will no longer be affiliated with the remainder of the disaggregated businesses. In effect, the current vertically-integrated PG&E will become a distribution company only and its generation, electric transmission and gas storage and transmission operations will be

unbundled into separate companies that remain affiliated with one another under the Parent, but unaffiliated with Reorganized PG&E.

Under this Plan, only Reorganized PG&E will be subject to CPUC regulation. Indeed, as the CPUC has recently stated in its November 27, 2001 bankruptcy filing in response to PG&E's proposed disclosure statement:

> Through its Plan and Disclosure Statement PG&E seeks to affect a regulatory jailbreak unprecedented in scope in bankruptcy annals. Under the guise of section 1123(a)(5) of the Bankruptcy Code and through a misapplication of the debtor protection provisions of chapter 11, PG&E seeks sweeping preemptive relief primarily in the form of no fewer than fifteen affirmative declaratory and injunctive rulings, each designed to permanently dislocate various state and local laws and regulations affecting PG&E's operation of its public utility. (Fn omitted). PG&E's Plan is concerned only secondarily with adjusting debtor-creditor relations and restoring its utility operations to financial health. To be sure, if those were PG&E's primary concerns, then it would have proposed a much more straightforward reorganization strategy. PG&E has as its own agenda an escape from CPUC and State regulation.[1]

II. THE STATUS OF THE BANKRUPTCY PROCEEDINGS

The status of the PG&E bankruptcy proceeding is discussed in the CPUC's contemporaneously filed pleading in Docket Nos. EC02-31-000 et al., and incorporated herein by this reference.

III. FERC LACKS JURISDICTION TO APPROVE THE APPLICATION, AND THEREFORE SHOULD DISMISS THE APPLICATION.

Pursuant to section 204(f) of the FPA, FERC lacks jurisdiction to authorize the issue of securities or the assumption of liabilities by a public utility where the utility's security issues are

[1] See p. 3 of "California Public Utilities Commission's Objection to Proposed Disclosure Statement for Plan of Reorganization Under Chapter 11 of the Bankruptcy Code for Pacific Gas and Electric Company Proposed by Pacific Gas and Electric Company and PG&E Corporation," filed November 27, 2001. In re Pacific Gas and Electric Company, United States Bankruptcy Court Northern District of California, San Francisco Division, Case No. 01-30923 DM.

regulated by a state commission. 16 U.S.C. § 824c(f); *Kansas City Power & Light Co.*, 53 FERC ¶61,097, at p. 61,280 n.54. Here, applicant PG&E is a public utility organized and operating under the laws of the State of California. Applicants ETrans and Gen also will be public utilities under state law, once they commence operations.[2] Section 818 of the California Public Utilities Code vests in the California Public Utilities Commission authority to regulate Applicants' security issues, providing:

> No public utility may issue stocks and stock certificates, or other evidence of interest or ownership, or bonds, notes, or other evidences of indebtedness payable at periods of more than 12 months after the date thereof unless, in addition to the other requirements of law it shall first have secured from the commission an order authorizing the issue, stating the amount thereof and the purposes to which the issue or the proceeds thereof are to be applied, and that, in the opinion of the commission, the money, property, or labor to be procured or paid for by the issue is reasonably required for the purposes specified in the order, and that, except as otherwise permitted in the order in the case of bonds, notes, or other evidences of indebtedness, such purposes are not, in whole or in part, reasonably chargeable to operating expenses or to income.

FERC, accordingly, lacks jurisdiction over this application, and must dismiss the proceeding. The CPUC hereby moves for such dismissal.

In a footnote in its application ("App."), PG&E acknowledges this jurisdictional barrier, but argues that section 204(f) does not apply here because it has asked the bankruptcy court to declare preempted any and all state laws that might impede PG&E's reorganization plan. App. at

[2] See Cal. Pub. Util. Code §§ 216, 217, 218.

6 n.9.[3] This argument lacks merit for at least two reasons.

First, unless and until the bankruptcy court grants PG&E's request regarding preemption, there is valid, enforceable state law regulating PG&E's security issues, and under section 204(f), FERC simply lacks jurisdiction to grant or consider PG&E's application at this time.

Second, even if the bankruptcy court were to determine that there is an irreconcilable conflict between the Bankruptcy Act and state law, and accordingly declares state law preempted, such a declaration would have no effect on the Federal Power Act. It is axiomatic that the FPA was designed to supplement, not to supplant, state law, and reflects a clear Congressional preference for state regulation of utilities. *See, e.g., Connecticut Light & Power Co. v. FPC*, 324 U.S. 515, 525-26 (1945). Section 204(f) embodies an explicit expression of Congressional intent that this Commission **not** act to regulate utility security issues where state law governing them exists. That the bankruptcy court might determine that there is a conflict between the Bankruptcy Act and state law – such that for the purposes of its bankruptcy jurisdiction state law is unenforceable – can have no bearing on the express statement of Congress in the Federal Power Act that public utilities seeking to issue securities must obtain permission from state commissions to do so, where the state has enacted legislation giving those commission authority to so regulate.

This Commission is governed by, and obtains its authority from, the Federal Power Act, not the Bankruptcy Act or the bankruptcy court. Where Congress has spoken, FERC cannot

[3] We note that Section 34.3(g) of the Commission's regulations requires an applicant for the issuance of securities to provide a statement as to whether or not any application with respect to the transaction or any part thereof is required to be filed with any State regulatory body. In Section G of its application (App. at 22-23), PG&E has blatantly misstated the relevant facts. As noted above, Section 818 of the California Public Utilities Code unquestionably requires CPUC approval of the transaction. However, in note 9, PG&E waves off this indubitable fact of State jurisdiction over the transaction in question by a bald assertion that the Bankruptcy Court will rule in its favor on the very complex preemption issues that are currently before it.

ignore the mandate. Bankruptcy courts themselves recognize this important distinction. In *In re: Cajun Elec. Power Coop.*, 230 B.R. 715 (M.D. La. 1999), for example, part of the debtor's reorganization was to obtain Exempt Wholesale Generator ("EWG") status for some of its generation. Indeed, the bankruptcy court referred to this feature of the plan as "a strong condition precedent" to its consummation. *Id.* at 746. Normally, to acquire EWG status for certain facilities, the Public Utility Holding Company Act ("PUHCA"), 15 U.S.C. § 79z-5a, requires an applicant to obtain certain certifications from relevant state commissions. The debtor argued that because obtaining EWG status was a central feature of its reorganization plan, federal bankruptcy law should trump other federal law, and no state commission certification should be required. 230 B.R. at 746. The bankruptcy court disagreed, holding that where Congress, in PUHCA, had expressly conditioned obtaining EWG status on also obtaining state commission certifications, the debtor had to seek and obtain such certifications, even if that meant that its plan might not be feasible (if the state commission withheld its certification). *Id.* at 746-47.

Exactly the same reasoning applies here. Regardless of what the bankruptcy court says about state law in PG&E's proceedings there, this Commission cannot ignore the jurisdictional requirement of section 204(f).

IV. THE APPLICATION SHOULD BE DENIED ON THE MERITS.

If FERC declines to dismiss for lack of jurisdiction, it should deny the application on its merits. Under section 204, FERC can approve the application only if it determines that the securities issue or liability assumption: "(a) is for some lawful object, within the corporate purposes of the applicant and compatible with the public interest, which is necessary or appropriate for or consistent with the proper performance by the applicant of service as a public utility and which will not impair its ability to perform that service, and (b) is reasonably

necessary or appropriate for such purposes." 16 U.S.C. 824c(a). Here, PG&E's application fails virtually every prong of this standard: It is not for a lawful object, it is not compatible with the public interest, it will impair PG&E's ability to serve as a public utility, and the entire underlying transaction is neither necessary nor appropriate for the purposes to which PG&E points.

The purpose of the transactions at issue here is, inter alia, to allow PG&E to transfer its generation assets to an affiliate of PG&E Corporation, currently PG&E's parent. App. at 22. In January 2001, the California State Legislature enacted Assembly Bill (AB) X1 6, which prohibits California's investor-owned utilities, including PG&E, from disposing of generation facilities that they own before January 1, 2006, providing in relevant part: "Notwithstanding any other provision of law, no facility for the generation of electricity owned by a public utility may be disposed of prior to January 1, 2006." Cal. Pub. Util. Code § 377. The application at issue here seeks to have this Commission approve the issue of securities and assumption of liabilities for the purpose of violating that statute. Accordingly, the object of the transactions that PG&E asks FERC to authorize in this proceeding is patently unlawful, and the application must be denied.[4]

PG&E argues that the transactions will not impair its ability to perform its function as a public utility, because separation of generation, transmission and distribution businesses "has been approved by FERC because it furthers objectives related to competition." App. at 24. However, the decisions cited in PG&E's application do not stand for the sort of radical unbundling of ETrans and Gen that PG&E seeks to accomplish through the November 30

[4] PG&E argues, in effect, that although its plan currently seeks to violate state law in numerous ways, it will become lawfi the Bankruptcy Court confirms the plan, including PG&E's request for a declaration that all applicable state law is preem App. at 23. This argument, if accepted, merely demonstrates why this application should be dismissed as premature. PG own timetable does not contemplate execution of the plan for at least another eleven months. App. at 30. And even if the Bankruptcy Court does ultimately confirm the plan, its legality still will be subject to years of appeals. At the present tim is indisputable that the object of this application is unlawful, and unless and until the Bankruptcy Court states otherwise, a the judgment of the Bankruptcy Court is affirmed, PG&E's claims concerning the legality of this application are hypothet and speculative at best.

Filings. FERC has stated, e.g., that "we . . . encourage utilities to *explore whether* corporate unbundling or other restructuring mechanisms may be appropriate *in particular circumstances*." *See id.* at 24 n.55 (emphasis added) (quoting Order 888). This does not say, and does not mean that all unbundling of utility assets will either "further objectives related to competition" or be in the public interest.

Applicants suggest that divestiture of generation and transmission assets from the utility is "encouraged by the Commission." App. at 24. Applicants point to an application by Southwest Gas Corp. 43 FERC ¶ 61,257 ("*Southwest*") (App. at 24 n.55) as evidence of the Commission's interest in such divestiture. Contrary to Applicants' suggestion, however, the *Southwest* decision had to do with regulatory jurisdiction, not with the wisdom of asset divestiture. A careful review of the Commission's decision in the *Southwest* case shows that it bears no resemblance to the present case. For example, in its *Southwest* decision, the Commission stated: "Reorganization would remove the possibility of dual regulatory authority over Southwest and would enhance the operation and delivery of services for the benefit" of its customers. (Emphasis added.) 43 FERC, at 61,709. Note that Applicants in this case make no claim, and can make no claim, of enhanced service as a result of its proposed divestiture. Thus, Applicants' reliance on the *Southwest* decision is misplaced.

The Applicants also point to this Commission's Order No. 888 as support for the Applicants' assertion that utility asset divestiture is encouraged by the Commission. In fact, Order No. 888 does not encourage such actions by utilities, but, instead, discusses the desirability of achieving *functional* unbundling of wholesale services in order to "implement non-discriminatory open access transmission." FERC Stats. and Regs., at 31,654. Functional unbundling refers to the creation of separate tariffs for wholesale generation, transmission, and

ancillary services; the separation of transmission employees from those involved in wholesale power merchant functions; and the use of the same information system as its transmission customers use when buying or selling power.

In Order No. 888, the Commission said that other mechanisms, such as divestiture, "may be appropriate in particular circumstances." *Id.*, at 31,656. However, Applicants in this case have not identified why these particular circumstances requires the "intrusive and potentially more costly mechanism" of divestiture. *Id.*, at 31,655. Contrary to the implication urged by Applicants, in Order No. 888, the Commission stated "that corporate unbundling should not now be required." (Emphasis added.) *Id.*

As both the California Legislature and FERC have recognized, the particular circumstances that obtain in California's energy markets at this time strongly dictate against a utility divesting itself of all of its own generation assets, as this application seeks authorization to do. The California Legislature recognized as much when it enacted ABX1 6, prohibiting utilities from disposing of their remaining generation. FERC reached the same conclusion, when in an order dated December 15, 2000, it noted that utility retained generation was an important measure to be taken in mitigating wholesale power costs, and thus in ensuring utilities' ability to provide required services. San Diego Gas & Electric Company, et al., 93 FERC ¶ 61,294 (2000) at 62,001 (As a result of the order, "the IOUs will be able to provide power from their own resources to serve their own load . . . The best way to mitigate cost exposure is for the IOUs to cease selling and repurchasing what they already produce").

Moreover, the financial data submitted by applicants to support their contention that these transactions will leave them financially sound is wholly inadequate. It is not a coincidence that the vast majority of electric utilities are integrated, using the utility's own generation,

transmission and distribution assets. Such vertical integration has been found to yield beneficial economies in the provision of electric services. These are often referred to as economies of scope or economies of diversification.[5] Sources of such economies are usually from the sharing of centralized functions such as management, planning, engineering, information technology, and general and administrative overhead. Section 854 of the California Public Utilities Code recognizes such economies and, in the case of the merger of utilities, requires that such economies be identified and quantified so that ratepayers might share in the savings engendered by the merger.

The quantification of the scope economies lost due to the divestiture of assets, especially assets that were designed and developed especially to work together efficiently to deliver services to a specific customer base, is difficult to analyze prior to the actual separation. Applicants have not submitted any cost studies or estimates covering the independent operation of the assets to be divested, if such studies or estimates have even been made. However, the Applicants propose to have the reorganized post-bankruptcy PG&E enter into a contract with Gen for the purchase of electric generation over the next twelve years. The price called for in this contract is 4.6 cents per kWh for the first year, and 5.1 cents per kWh on average for subsequent years.[6] Applicants estimate 33,000 GWh output for this contract in 2003. PG&E projects a total income from this contract of $1,471.5 million for the first year. However, the cost of producing the energy for this contract is only 2.5 cents per kWh, according to Applicants' own figures. See the CPUC's contemporaneous pleading in Docket Nos. EC02-31-000 et al. This represents an excess of nearly $700 million that Gen will receive over its costs for the first year. Assuming that

[5] See for instance William G. Shepherd, *The Economics of Industrial Organization*, Prentice Hall, fourth ed., 1997, p. 152; Michael A. Crew and Paul R. Kleindorfer, *The Economics of Public Utility Regulation*, MIT Press, 1986, pp. 22-25.

[6] PG&E Disclosure Statement for the First Amended Plan of Reorganization, p. 106.

ratepayers will pay 5.1 cents per kWh for years 2004 –2013, Gen will receive a surplus approximating $768 million per year or $8.3 billion for the first 11 years of the contract. This surplus represents a gigantic windfall to Gen at the expense of PG&E and its ratepayers.

Much of this difference between the average costs now experienced by the still-intact utility is undoubtedly due to market power that will be exercised by Gen; however, market power may not explain a price differential of 89%. It is likely that a portion of this difference is due to increased average cost, due mainly in turn to a loss of scope economies when the assets are divested by the utility. It is also true that some of this difference could be due to increased transaction costs engendered by the Plan, including the additional legal costs of obtaining authorizations from several overseeing and regulatory bodies. However, these transaction costs should be one-time and not reflected in out-years. Nevertheless, such costs are a measure of the inefficiency of the Plan and, combined with the additional market power and loss of scope economies, contribute to the conclusions that (1) the transfer of assets from the utility to Gen works against the public interest, and (2) there can be no basis for the Commission to find that the proposed transaction will leave the reorganized post-bankruptcy PG&E financially sound.

Applicants state that the reorganized utility and new companies Gen and ETrans "will be on a sound financial footing after the reorganization," and point to Exhibits C-2, D-2, and E-2 for proof of this assertion. However, these tables are very assumption laden, as Applicants acknowledge in Attachment 2 to the application. For example, p. 6 of Attachment 2 addresses expected operating expenses for Gen following execution of the Plan. Item 2.b states: "Normal expenses are based on the Company's historic level of spending prior to the passage of [California Assembly Bill] 1890." However, this assumption ignores the loss of scope economy and the additional transaction costs (discussed above) due to the transfer of assets required by

Applicants' Plan. Note that on page 6 of Attachment 2, Applicants provide only a definition of M&O and A&G expenses and do not provide the assumptions on which these numbers and projections are based in Exhibit D-2. Thus, even if these numbers are based upon an assumption of "normalcy" or linear projection from before the California restructuring legislation was passed, such assumptions ignore certain realities regarding costs resulting from the divestiture of assets from the utility.

Applicants state that "the Plan will improve the ability of Applicants to access capital markets . . ." App. at 25. Given the flaws indicated here regarding Applicants' projections of costs, it is impossible for Applicants to make such a claim. If profits are affected significantly, Applicants access to capital markets may be seriously flawed. In fact, given such flaws, it is likely that the alternate plan offered by the CPUC would provide more access to capital markets than the Plan proposed by the Applicant.

Of interest in this regard is the debt to equity ratio projected by the Applicants in Exhibit C-2. The second table entitled "Projected Balance Sheet of Reorganized PG&E" indicates that the projected debt to equity ratio is 56:44 at the end of 2002. It was reported recently at Bloomberg.com that "An energy company's debt should not outweigh its equity, if the business holds an investment grade credit rating . . ." according to Moody's analysts.[7] "The sensitivity and volatility of the power markets and the financial markets as a result of what has happened in the sector have made us more sensitive and made us take a second look." *Id.* This suggests, contrary to the Applicants' assertions, that the Plan advanced by the Applicants would not leave the reorganized utility with significant access to capital.

[7] "Moody's Says Energy Company Leverage should be Less than 50%," Terence Flanagan, *Bloomberg*, December 20, 2001.

PG&E next claims, "Each of the Applicants will continue to be subject to regulation with respect to its rates, financing, and disposition of facilities, either by the CPUC . . . or by this Commission." This statement is far from true. Under PG&E's plan, Gen will not own any generation facilities itself; individual LLC subsidiaries of Gen will. PG&E has specifically requested that this Commission find that the individual LLCs will not be public utilities subject to FERC's jurisdiction. This request suggests that if one of the LLCs wants to dispose of the facility it owns, it, along with Gen, will argue that that disposition is not subject either to section 203 of the FPA, or to section 851 of the California Public Utilities Code. Furthermore, three of the hydropower facilities that these applications propose to transfer (namely, the Hamilton, Lime Saddle, and Coal Canyon facilities) currently are subject *only* to CPUC regulation, and do not possess FERC licenses.[8] If these transactions are approved, the three facilities in question will be subject to no regulation whatsoever.

V. THE AUTHORIZATIONS REQUESTED IN THE APPLICATION CONTRAVENE THE PUBLIC INTEREST

Finally, these transactions are patently not in the public interest. The transactions proposed in Applicants' Section 204 Application will produce detrimental effects on competition and rates, and will create substantial regulatory gaps. San Diego Gas & Electric Co. 79 FERC ¶ 61,372 (1997) ("SDG&E"). In addition, other factors relevant in this matter to any public interest determination weigh heavily against approval of the authorizations sought by PG&E. 18 C.F.R. 2.26(b). In its related Section 203 Application, PG&E proposes to divest itself of its most valuable assets for a fraction of their value, while retaining billions of dollars worth of liabilities. Moreover, adequate protection of the public interest requires that the environmental implications

[8] See pages 6-7 of the Executive Summary of the Draft Environmental Impact Report, which is attached to the CPUC's contemporaneously filed pleading in Project No. 77-116, *et al.*

of the proposed transactions be fully considered. Finally, approval of this Section 204 Application and the related November 30 Filings would be inconsistent with the prompt emergence from Bankruptcy of PG&E. As in the SDG&E case, FERC must act in partnership with the state to assure that the public interest is fully protected. Each of these issues is discussed in greater detail in section VI of the CPUC's contemporaneously filed pleading in EC02-31-000 et al., the substance of which is incorporated herein by this reference.

VI. APPLICANTS' REQUEST FOR A WAIVER FROM THE COMPETITIVE BIDDING REQUIREMENTS SHOULD BE DENIED

Finally, Applicants have requested an exemption from the competitive bidding requirements imposed by 18 C.F.R. § 34.2. Section 34.2 of the Commission's regulations requires that securities authorized under Section 204 of the FPA be issued through either a competitive bid or a negotiated placement. Competitive bids require at least two "prospective dealers, purchasers or underwriters," while negotiated offers require at least three such agents. Applicants request waiver of these requirements.[9] However, such an exemption is unnecessary and is not sufficiently justified by Applicants.

Applicants assert that if they are required to put the securities that are the subject of this application out to competitive bid, they will lose control of the timing of these offerings, causing potential buyers to require a risk premium to be added to the price. This is exacerbated by the structural complexity of the transactions proposed by the Applicants' Plan. See App. at 10. The Applicants want to be authorized to choose the method and specific underwriters appropriate to the "market conditions and other factors so as to maximize their access to capital markets and minimize their cost of funds." App. at 11.

[9] Applicants refer only to "competitive bid requirements," without specific reference to the negotiated offers option. We assume that the Applicants consider both to be competitive and are asking for exemption from both.

However, Applicants have ignored that the purpose of Section 34.2 is to encourage the use of financial markets and competition to attempt to get the best price and terms for the utility. To suggest that a private deal would yield a lower price and superior terms than a competitive process has not been supported by Applicants. Generally, financial markets are considered highly efficient, as long as entry is not impaired. It is not necessary to seek out "a small number of sophisticated investors" (App. at 12), as the financial market already relies on such sophistication and information, as well as on that provided by a large number of other analysts, to determine the correct and efficient price of an asset. This correct and efficient price is the price that will satisfy Section 34.2(3)(i) and (ii).

Moreover, the Applicants also do not explain why the timing of the offerings would result in a higher risk premium demanded by lenders. Other factors, such as the unrecognized additional costs to implement the Plan identified in this filing, may increase the risk in the eyes of the market, but the timing of the offering should not be one of them.

If there are underwriters familiar "with Applicants' financial situation and the energy industry . . ." (p. 11), they will come forward in the competitive process. If the Plan is "structurally complex," it is safer to rely on the discipline of the market to anticipate and discount problems than to expect management that has, with all due respect, an uneven record at best, to do a better job. We are left with the Applicants' unsubstantiated claim that they will make sure that the fees, commissions and expenses are comparable to market-determined costs (App. at 12). The Commission should accordingly deny Applicants' request for an exemption from the competitive bidding requirements imposed by 18 C.F.R. § 34.2.

VII. CONCLUSION

For all of the foregoing reasons, the application filed herein should be dismissed for lack of jurisdiction or, in the alternative, denied on the merits.

Dated: January 29, 2002

Respectfully submitted,

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EXHIBIT F

UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

Electric Generation LLC	Docket No. ER02-456-000

MOTION FOR SUMMARY DISPOSITION, OR IN THE ALTERNATIVE, PROTEST AND REQUEST FOR CONSOLIDATION AND HEARING, OF THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Pursuant to Rules 211, 212, and 217 of the Rules of Practice and Procedure ("Rules") of the Federal Energy Regulatory Commission ("FERC"), the Public Utilities Commission of the State of California ("CPUC"), hereby protests the filing made in the above-referenced docket, and moves for the summary disposition of the application ("the Gen application"). In the alternative, if the Gen application is not summarily rejected, the CPUC requests that the proceeding be consolidated with PG&E's related November 30 Filings and set for hearing. The CPUC is a constitutionally-established agency charged with the responsibility for regulating natural gas and electric corporations within the State of California. In addition, the CPUC has a statutory mandate to represent the interests of natural gas and electric consumers throughout California in proceedings before the Commission. The CPUC previously filed a Notice of Intervention in this proceeding on December 14, 2001.

I. THE GEN APPLICATION

On November 30, 2001, Electric Generation LLC ("Gen") filed an application with the FERC pursuant to Section 205 of the Federal Power Act, and Part 35 of FERC's

regulations, an application for acceptance of a power sales agreement and interim code of conduct and grant of various waivers. Gen is currently a subsidiary of Pacific Gas & Electric Company (PG&E). The filing of this application is one part of a complex series of filings ("November 30 Filings") made by PG&E before the FERC as part of the implementation of PG&E's proposed "Plan of Reorganization under Chapter 11 of the Bankruptcy Code for Pacific Gas and Electric Company" ("Plan") jointly filed by PG&E and its Parent with the Bankruptcy Court on September 20, 2001.

As detailed elsewhere,[1] PG&E's Plan proposes to transfer PG&E's electric generation, electric transmission, and natural gas transportation facilities to PG&E's Parent, PG&E Corporation, leaving a Reorganized PG&E to emerge from bankruptcy as an underfunded distribution-only utility possessing only assets and liabilities not desired by the corporate parent. Included is a proposal to transfer all of PG&E's hydroelectric and nuclear generation facilities to Gen, and then to transfer Gen to the corporate Parent by means of an unlawful stock dividend in violation of § 305 of the FPA.[2] Should the various proposed transactions culminating in the proposed "Spin-Off" be approved, PG&E proposes that Gen enter into a proposed Purchase & Sale Agreement ("PSA") with Reorganized PG&E which is the subject of the instant proceeding. Under the PSA Gen proposes to sell all of the output of the (former) PG&E generation facilities to Reorganized PG&E for an eleven year period at an unjust and unreasonable price, approaching double the rates PG&E would receive for the output of the facilities in the absence of the proposed transactions, and justified only by the need to service the

[1] See CPUC pleadings filed contemporaneously in Docket Nos. EC02-31-000 et al.. ER02-456-000. ES02-17-000, CP02-39-000 et al. and P 77-116 et al.

[2] See CPUC pleading filed contemporaneously in Docket Nos. EC02-31-000.

unnecessary debt which Gen proposes to incur upon receipt of the facilities (the PSA includes a twelfth year for approximately half of the facilities' output).[3]

Under this Plan, only Reorganized PG&E would be subject to CPUC regulation. Indeed, as the CPUC has recently stated in its November 27, 2001 bankruptcy filing in response to PG&E's proposed disclosure statement:

> Through its Plan and Disclosure Statement PG&E seeks to affect a regulatory jailbreak unprecedented in scope in bankruptcy annals. Under the guise of section 1123(a)(5) of the Bankruptcy Code and through a misapplication of the debtor protection provisions of chapter 11, PG&E seeks sweeping preemptive relief primarily in the form of no fewer than fifteen affirmative declaratory and injunctive rulings, each designed to permanently dislocate various state and local laws and regulations affecting PG&E's operation of its public utility. (Fn omitted). PG&E's Plan is concerned only secondarily with adjusting debtor-creditor relations and restoring its utility operations to financial health. To be sure, if those were PG&E's primary concerns, then it would have proposed a much more straightforward reorganization strategy. PG&E has as its own agenda an escape from CPUC and State regulation.[4]

On December 13, 2001, the FERC issued its "Notice of Filing," setting until January 30, 2002, for the filing of interventions and protests in this docket. On January 22, 2002, the CPUC on behalf of Joint Parties including the California Electricity Oversight Board, the People of the State of California, and the California Resources Agency filed a Joint Motion seeking to have the November 30 Filings dismissed, or in the alternative, held in abeyance pending certain rulings of the Bankruptcy Court ("Joint

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[3] See "Joint Parties' Motion to Dismiss et al." filed January 22, 2002, setting forth the outlines of the CPUC's proposed Alternative Plan for PG&E to emerge from bankruptcy without dismantling the utility.

[4] See p. 3 of "California Public Utilities Commission's Objection to Proposed Disclosure Statement for Plan of Reorganization Under Chapter 11 of the Bankruptcy Code for Pacific Gas and Electric Company Proposed by Pacific Gas and Electric Company and PG&E Corporation," filed November 27, 2001, In re Pacific Gas and Electric Company, United States Bankruptcy Court Northern District of California, San Francisco Division, Case No. 01-30923 DM.

Motion"). The Joint Motion requested that FERC issue a ruling granting the motion by January 25, 2002.

II. THE STATUS OF THE BANKRUPTCY PROCEEDINGS

The status of the PG&E bankruptcy proceeding is discussed in the CPUC's contemporaneously filed pleading in Docket Nos. EC02-31-000 et al., and incorporated herein by this reference.

III. PROTEST AND MOTION FOR SUMMARY DISPOSITION, OR IN THE ALTERNATIVE, TO SET THE PROCEEDING FOR HEARING

The CPUC protests the Gen application and each of the authorizations and approvals requested. The CPUC's preliminary review of the Gen application discloses strong indications that the pricing, terms and conditions of the PSA are not just and reasonable, as discussed further below. The CPUC accordingly requests that the Gen application be dismissed. In addition, with additional time and formal discovery rights, the CPUC is likely to be able to identify additional issues not expressly discussed below. Accordingly, if the Gen application is not dismissed, FERC should set this matter for hearing without limiting parties to any other issues which may be raised. In addition, FERC should consolidate PG&E's November 30 Filings for hearing.

A. The Gen Application Should be Dismissed

The CPUC renews the arguments made in the Joint Motion for dismissing the Gen application as premature, or alternatively, holding this proceeding in abeyance, and incorporates the Joint Motion herein by this reference. In addition, the Gen application should be dismissed pursuant to § 35.3(a) of FERC's regulations. Section 35.3(a) requires that rate schedules be tendered no more than 120 days prior to the date on which service is to commence. In the instant proceeding, PG&E has tendered the PSA as a rate

schedule thirteen months prior to the earliest date on which it anticipates service may commence. While FERC has on occasion waived the 120 day requirement, good cause for waiver is not present in this matter. To the contrary, and as set forth in greater detail in the Joint Motion, the Gen application is premature and should be dismissed in order to avoid the expenditure of very substantial resources both by the parties and FERC, all of which may be rendered moot by rulings of the Bankruptcy Court expected in fairly short order.

Moreover, the substantive issues raised below support summary rejection of the Gen application. PG&E has wholly failed to meet the standards applicable to power sales agreements between affiliates. Under the circumstances here, the applicable standards must be applied with extraordinary scrutiny. The PSA was not reached at arm's-length by entities with competing interests, but rather were developed by the same counsel working simultaneously for all the (affiliated!) parties, one of which is essentially non-existent. PG&E concedes that the PSA was developed, on behalf of both the "buyer" and "seller" by a single "Team [which] developed the price, terms and conditions of the PSA." Ex Gen-1 (Kuga Testimony) at 11.

Finally, the PSA proposed in this docket is part and parcel of a coordinated set of applications which in whole and in part are contrary to the public interest as expressed in both state and federal law. For the reasons set forth in greater detail in the CPUC's contemporaneous pleading in Docket Nos. EC02-31-000 et al., the Gen application must be dismissed on this basis as well.

B. The Rates in the Proposed PSA Are Unjust and Unreasonable to Reorganized PG&E and its Retail Customers Who Will Foot the Bill

The heart of the Gen application is PG&E's contention that the rates in the proposed PSA are just and reasonable to Reorganized PG&E on the basis of a "benchmark" analysis conducted by witness Meehan. As set forth in detail below, PG&E's "benchmark" analysis misses the mark. First, the rates in the proposed PSA must properly be evaluated not against other long-term power transactions, but rather against the rates which PG&E would receive in the absence of the proposed Spin-Off and related transactions. That is, the proposed PSA rates must be compared against the CPUC's rates for Utility Retained Generation. Second, even if it is appropriate to measure the proposed PSA against "comparable" wholesale transactions, PG&E's benchmark analysis fails to establish that the proposed PSA rates are just and reasonable. Third, PG&E fails to provide a cogent analysis of its market power. Consequently, PG&E fails to establish that the price and non-price terms and conditions of the PSA are just and reasonable, and that the PSA is not fatally tainted by self-dealing.

1. The Proposed PSA Rates Must be Evaluated in Comparison with Otherwise Applicable Rates

Under PG&E's proposal, Gen will sell the output of the electric generation facilities currently owned and operated by PG&E to Reorganized PG&E, which would in turn resell the facilities' output to its retail customers. In the absence of the transactions proposed in PG&E's Plan, PG&E would retain the electric generation assets which it proposes to transfer to Gen and the GenSub LLCs, and would continue selling the output

of the generation facilities directly to its retail customers.[5] Under either scenario PG&E's retail customers will receive the same energy and Ancillary Services from the same facilities. Thus, the appropriate comparator against which to measure the PSA is the utility-retained generation ("URG") component of PG&E's retail rates.

Under current California law and CPUC policy, such rates are determined on a traditional cost-of-service basis. See e.g. Application of San Diego Gas & Electric Company et al., D.01-12-015, 2001 Cal. PUC LEXIS 1072, *7 ("We intend to apply cost-based ratemaking to all of SDG&E's retained generation assets . . . which we believe is consistent with ABX1 6"); Application of Southern California Edison Company et al., D.01-01-061, 2001 Cal. PUC LEXIS 30 ("PG&E, SDG&E and Edison shall establish a cost-based rate for URG"). The CPUC has expressly rejected PG&E's request to set its URG revenue requirement based on market valuation rather than cost-of-service. Application of Southern California Edison Company et al., D.01-10-067, 2001 Cal. PUC LEXIS 959 ("We determine that market valuation does not apply to setting a prospective revenue requirement for PG&E's URG assets").

PG&E's witness Meehan states that the levelized price over the twelve-year period of the PSA is approximately $52.29/MWh. Application at 4. Elsewhere PG&E asserts that the average price under the contract over the life of the contract is approximately 5.1 cents/kWh ($51/MWh). Application at 3. That the contract costs are unjust and unreasonable as to Reorganized PG&E (and to its retail ratepayers) is confirmed by PG&E's own numbers. In its Plan, PG&E projects revenues under the

[5] As discussed in greater detail in the Joint Motion and in the CPUC's contemporaneously-filed pleading in Docket Nos. EC02-31-000 et al., the CPUC has formulated an Alternative Plan under which PG&E would be able to emerge from bankruptcy without disposing of its electric generation assets.

contract of approximately $1.5 billion annually. For calendar year 2003, PG&E projects revenues under the contract of $1,471,500,000. See Exhibit A hereto (Ex C. to Plan, at 10). Based solely on the numbers presented by PG&E in its Plan, PG&E's revenue requirement based on traditional cost-of-service principles would be approximately $790.4 million for 2003—about half of PG&E's projected revenues. This translates to an illustrative rate of approximately 2.5 cents/kwh.[6]

This calculation proceeds as follows: PG&E's Plan projects total operating expenses for Gen in 2003, including depreciation, of $759.7 million. From this figure is subtracted "other income" of $88.9 million, leaving net operating expenses of $670.8 million. To this is added a rate of return and taxes of $119.6 million, calculated utilizing PG&E's projected 2003 net plant shown in the Plan of Reorganization for the nuclear and hydro assets of $913.8 million and PG&E's rate of return grossed up for income tax authorized by the CPUC of 13.09%.[7] This results in an illustrative cost-of-service revenue requirement for Gen, using PG&E's own figures, of $790.4 million for 2003.

The illustrative cost-of-service revenue requirement of $790.4 million is 53.7% of the proposed revenues PG&E would receive under the PSA in 2003 of $1,471.5 million. PG&E asserts that rates under the PSA in 2003 would be approximately 4.6 cents/kWh. Since, as PG&E asserts, revenues of $1,471.5 million equates to 4.6 cents/kWh on

[6] This pleading does not purport to determine the rate which the CPUC would actually set for PG&E's URG for any particular customer or class of customers, but simply utilizes figures provided by PG&E to provide, for illustrative purposes, a rough calculation of a cost-of-service rate based on such figures.

[7] PG&E's Plan shows higher figures for return, interest expense, and taxes, totaling $800.8 million, because the figures reflect and are being used to support the borrowing of over $2 billion to help pay off creditor claims. The $119.6 million in the calculation above includes interest expense on the net plant of $913.6 million, as it is based on a 13.09% weighted average rate of return that includes interest and taxes. See PG&E work papers submitted in CPUC Docket No. A.00-11-038, Scenario 1.

average, the cost-of-service revenue requirement is approximately 2.5 cents/kWh on average (.537 x 4.6 cents/kWh) for 2003.[8]

While a rate of 2.5 cents/kWh is low compared to recent prices for gas-fired generation, the rate reflects the resource mix utilized for the PSA and PG&E's actual costs—not including the cost of unnecessarily borrowing over $2 billion. PG&E's hydroelectric resources are highly depreciated. PG&E's nuclear and hydro pumped storage resources have been subject to accelerated depreciation during the transition period established under California's deregulation law. Ratepayers have paid several billion dollars of accelerated depreciation through California's Competitive Transition Charge, and would be losing a good portion of what they paid for under PG&E's Plan of Reorganization. See also the proposed decision addressing PG&E's revenue requirement for utility-retained generation ("the URG PD") recently issued by a CPUC ALJ (a proposed decision has a status somewhat analogous to a FERC ALJ's Initial Decision).[9]

While these figures may be subject to some refinement, this illustration demonstrates that the PSA is grossly overpriced. If the PSA were approved as proposed, PG&E's ratepayers would make some $700 million in excess payments to Gen over and above the otherwise applicable rate for the same energy from the same facilities in 2003. Over the life of the PSA, the overpayments approximate $8 billion.

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[8] A recent report issued by the consumer group TURN estimates the "Expected Price Under Regulation" at approximately 2.5 cents/kWh in 2003, and 2.9 cents over the term of the PSA. See "Highway Robbery: Unmasking the PG&E Bankruptcy Plan's Financial Impact on California Consumers," available at http://www.turn.org/turnarticles/PG&E_report.pdf.

[9] California law generally requires the CPUC's proposed decisions to be released for comment prior to a Commission vote. See Cal. Pub. Util. Code § 311(d), (g). The URG PD is available from the CPUC's web site, at http://www.cpuc.ca.gov/published/comment_decision/12655.htm. An alternate proposed decision of Commissioner Lynch is available at http://www.cpuc.ca.gov/published/Agenda_decision/12659.htm.

2. PG&E's Benchmark Analysis is Invalid

Assuming arguendo that the benchmark analysis utilized by FERC in connection with previous affiliate transactions is applicable, PG&E's benchmark analysis, supported by the testimony of witness Meehan, is invalid for a number of reasons, discussed below.

FERC has articulated standards pursuant to which it will accept power sales contracts between affiliates in a series of three orders over the past ten years. Boston Edison Co. Re: Edgar Electric Energy Co., 55 FERC ¶ 61,382 (1991) ("Edgar"); Ocean State Power II, 59 FERC $61,360 (1992), reh'g denied, 69 FERC ¶ 61,146 (1994) ("Ocean State"); Ameren Energy Mktg. Co., 96 FERC ¶ 61,306 (2001) ("Ameren"). In Edgar FERC stated that such arrangements will be permitted if two conditions are satisfied. First, FERC requires a showing that there exists no potential abuse of self-dealing or reciprocal dealing. Second, if there has been a showing of no potential abuse of self-dealing or reciprocal dealing, FERC has found that market-based rates may be acceptable if the seller can also demonstrate that it lacks market power (or has adequately mitigated its market power), under familiar principles. Edgar, 55 FERC at 62,167.

As PG&E recognizes, the potential for self-dealing is present here, where the seller under the proposed PSA is essentially non-existent, and the terms and conditions of the PSA were developed by a single entity acting on behalf of both the putative seller and buyer. The risk of self-dealing is at its height in this transaction, in which the buyer under the proposed PSA would, if PG&E's Plan is confirmed, be stripped of all of its most valuable assets and the affiliate relationship then terminated.

FERC has articulated three means by which lack of self-dealing or reciprocal dealing may be shown, to ensure that an affiliated "buyer has chosen the lowest cost supplier from among the options presented, taking into account both price and nonprice

terms (i.e., that it has not preferred its affiliate without justification"). Edgar, 55 FERC at 62,168. PG&E has chosen to present "benchmark evidence" of market value, i.e. evidence of other relevant power sales agreements between non-affiliates, which it claims demonstrates that the PSA is not unreasonable. See Application at 14 ff. Under the Edgar line of cases, the benchmark sales must be: (1) transactions in the relevant market; and (2) should be contemporaneous with; and (3) involve service that is comparable to, the instant transactions. In addition, FERC requires that the benchmark analysis examine nonprice as well as price terms, and assumptions used in comparing the various projects should be explained with respect to both price and nonprice terms. Finally, the applicant must demonstrate that the benchmark evidence was not distorted by exercise of market power by the seller or its affiliates. Ocean State, 59 FERC at 62,333. FERC has observed that it must "take into account the evolving nature of our analyses of market-based affiliate transactions," including changes to the national generation market. Ocean State, 59 FERC at 62,332.

PG&E contends that the relevant market is "the market for firm, long-term baseload and peaking capacity and energy for a duration of approximately 10-15 years with a start date expected near January 2003," and that the relevant region must be limited to suppliers which can deliver energy to PG&E. Application at 17. PG&E contends that the relevant "contemporaneous" period is May 2000 through November 2001. Application at 18. By so attempting to confine the analysis, PG&E contends that the appropriate benchmark sales are nine long-term contracts entered into by the California Department of Water Resources ("DWR") during 2001.

PG&E's Reliance on DWR Contracts

In confining its benchmark comparison to the DWR contracts, PG&E has sought to define as the relevant period precisely the same period in which the California wholesale electricity markets exhibited extreme dysfunction. PG&E has previously characterized this as a period of "massive market failure and upheaval in the regulatory regime that has led to billions of dollars in overcharges since May 2000."[10] Similarly, PG&E has attempted to confine its benchmark comparison to DWR contracts, the negotiation of which PG&E has previously contended were subject to the exercise of market power, and as to which PG&E has contended FERC ought to order refunds.[11] As PG&E stated in its Request for Rehearing of FERC's July 25, 2001 order (San Diego Gas & Electric Company, et al., 97 FERC 61,275 (2001), filed in Docket No. EL00-95 on August 24, 2001, at 12:

> the DWR bilaterals . . . have drawn the most attention. These transactions are not bilateral purchases in the conventional sense with a willing buyer and a willing seller. Rather, they reflect the state stepping into the shoes of insolvent utilities as the default buyer of power in order to backstop the ISO's efforts at maintaining reliability in a dysfunctional market."

PG&E's reliance on the DWR contracts for its benchmark analysis is fatal. The DWR contracts were negotiated and executed during a period of extreme exercise of market power, as FERC has acknowledged on repeated occasions. FERC has expressly recognized that the exercise of market power in the spot markets extended to the forward

[10] See PG&E's Request for Rehearing of FERC's July 25, 2001 order (San Diego Gas & Electric Company, et al., 97 FERC 61,275 (2001), filed in Docket No. EL00-95 on August 24, 2001, at 19.

[11] FERC has not found any specific DWR contracts to be "just and reasonable." See, e.g., GWF Energy, 97 FERC 61,297 (2001), slip op. at pp. 3-4.

markets during the time period to which PG&E seeks to confine the analysis.[12] Thus, the DWR contracts cannot be relied on to be a benchmark of market value in a competitive market, and cannot be relied on to demonstrate that the PSA reflects a competitive market value.[13]

The Relevant Market

In Ocean State FERC indicated that a benchmark analysis should consider as the geographic market suppliers that can supply the relevant product to the buyer. Ocean State, 59 FERC at 62,333. However, FERC also expressly stated that its analysis and holding in Ocean State were confined to the facts of that proceeding. Ocean State, 59 FERC at 62,338 n. 117. In this proceeding, it is inappropriate to consider only a geographic market centered on PG&E's service territory. First, as discussed above, an analytic limitation to contracts in PG&E's California service territory focuses the analysis on an environment of acknowledged market power.

Second, a broader geographic market is appropriate in this case due to the nature of the PSA. The PSA is a long-term agreement with a delayed implementation date. Developed in 2001, it is proposed that the PSA run from January 2003 through 2014. The market for such contracts is decidedly national, not regional. That is, a seller need not be physically located in California in 2001 in order to provide power under a 12 year contract commencing in 2003. Because of the long duration and delayed implementation date, a seller would have sufficient time to build new facilities to satisfy all but the

[12] San Diego Gas & Electric Company, et al., 93 FERC ¶61,121 (2000) at 61,358 ("higher spot prices in turn affect the prices in forward markets"); San Diego Gas & Electric Company, et al., 95 FERC ¶ 61,418 (2001), at 62,556 (expanded spot market mitigation plan "will, over time, impact bilateral and forward markets as well"); see also AEP Power Marketing, Inc., 97 FERC ¶ 61,219 (2001).

[13] Only a competitive market value is relevant to a section 205 just and reasonable analysis, as "t]he prevailing price in the marketplace cannot be the final measure of 'just and reasonable' rates mandated by the Act." FPC v. Texaco, 417 U.S. 380, 397 (1974).

earliest segments of the twelve year period. Certainly long-term capital markets are national, as are long-term natural gas markets.

That the long term market for electric generation is essentially national rather than regional is confirmed by an examination of regional pricing for forward electricity contracts. During the height of the California crisis western forward prices were substantially higher than forward contracts at other national trading hubs—as much as an order of magnitude higher. Since FERC's summer 2001 orders restored a measure of stability to western markets, however, forward contract prices at various regional hubs have tended to converge. For instance, as of December 12, 2001 (when the notice was issued in this proceeding) the simple average of reported futures prices for calendar year 2002 were $30.66 for the California-Oregon border ("COB"), $34.25 for PJM, and $30.80 for Cinergy.[14] Longer term prices should show similar convergence—a point which the CPUC will develop should this proceeding be set for hearing. As the relevant market for products similar to the PSA is a national rather than regional market, and PG&E analyzes only a corrupted regional market, PG&E's benchmark analysis fails to satisfy the "relevant market" prong of the benchmark analysis.

Contemporaneousness

PG&E's benchmark analysis similarly fails to satisfy the "contemporaneous" prong articulated in FERC's prior cases. PG&E examined only contracts "entered into between May 2000 and the date of this Application." Application at 18. Witness Meehan's benchmark analysis focuses on nine contracts entered into between February and August 2001 as his "comparison group." Application at 21-22. As discussed above,

[14] See www.enerfax.com. By late January 2002, prices in all three markets had declined.

this is precisely the period in which all energy transactions in the California markets were tainted with market power. It is patently unreasonable to consider only such contracts. Moreover, this period is not contemporaneous with the period in which the PSA was developed. PG&E filed its Plan with the Bankruptcy Court on September 20, 2001. It filed the instant application on November 30, 2001. The key event in this scenario is the order issued by FERC on June 19, 2001, which quickly restored a semblance of stability to the California markets. All of the contracts in witness Meehan's "comparison group" were either executed or had an executed letter of intent no later than June 22, 2001.[15] That is to say, the negotiation of all of the comparison group contracts took place in the market power period. By the fall of 2001 when the PSA was developed, forward contract prices in California had already begun to converge with forward prices in regional markets across the country, at prices well below the prices in the PSA. PG&E has thus failed to examine any contemporaneous contracts in its benchmark analysis.

In Ocean State FERC approved a benchmark analysis which considered as the relevant period late 1987 into 1989, "reflecting the period during which the purchasers made their decisions to contract with Ocean State II." Ocean State, 59 FERC at 62,334. PG&E provides no similar justification for the period it has chosen. Certainly PG&E makes no claim that that the roughly eighteen month period it has selected for examination represents the only, or even the most relevant, time period in which buyers seeking energy for the 2003-2014 period would have, or did, engage in negotiations.

The CPUC has no principled objection to a "contemporaneous" period of roughly eighteen months. But PG&E has disingenuously selected the precise 18 months in which

[15] See California State Auditor, "California Energy Markets: Pressures Have Eased, But Cost Risks Remain," 193-195, Table 10. The report is available at http://www.bsa.ca.gov/bsa/pdfs/2001009.pdf

the California market was at its most dysfunctional. Were there no long-term power contracts entered into in the western United States in the first quarter of 2000? In the last quarter of 1999? Or, for that matter, in the truly contemporaneous period—third and fourth quarter 2001? The "contemporaneous" period selected by PG&E is invalid on its face, particularly when coupled with the limited geographical market also selected by PG&E. Rather, FERC must acknowledge changing market conditions. Any valid benchmark analysis must, if not be limited to, certainly include an examination of contracts executed during a period of relative market stability. Such a period could include, for instance portions of 1999 and 2000, and the latter third of 2001. Evidence as to whether and to what extent buyers sought long-term contracts for period comparable to the PSA during these periods can be presented at hearing.

Comparability

As PG&E observes, FERC has held that benchmark evidence must encompass "similar services when compared to the instant transaction." Edgar, 55 FERC at 62,129; Ocean State at 62,333. PG&E's benchmark analysis fails this requirement as well. In the instant case, the PSA provides for capacity and energy from approximately 7,100 MW of hydroelectric and nuclear power plants. The size of the PSA alone disqualifies each of the purported "comparison group" contracts from consideration as comparable. Witness Meehan admits that he must treat each of the comparison group contracts as "infinitely scalable" in order to make a comparison. Application at 27; Ex Gen-2 (Meehan Testimony) at 16.

In Ocean State the applicant provided comparison evidence relating to 33 projects. FERC confined its analysis to the ten projects which were "comparable to

Ocean State II with respect to size and technology." Ocean State, 59 FERC at 62,334. Similarly, in Edgar, FERC rejected a benchmark showing in part due to the applicant's failure to evaluate the proposed rates against truly comparable projects. Edgar, 55 FERC at 62,169 ("Boston Edison's comparison of projects [against a 306 MW combined-cycle generating unit] includes projects as small as 0.7 MW and powered by wind, wood, waste, peat and hydropower"). Here, of course, the facilities proposed to support the PSA are exclusively hydroelectric and nuclear generating plants. The "comparison group" contracts, to the extent that they have any specific source of generation attached to them, are exclusively natural gas-fired units. The PSA is for some 7,100 MW. Only one of the comparison group contracts is within the same order of magnitude. The comparison group contracts are comparable in neither size nor technology to the PSA.[16]

Price

The foregoing establishes that PG&E's benchmark analysis fails to establish the absence of self-dealing in the development of the PSA. As such, the PSA may not be accepted. Edgar, 55 FERC at 62,170. Moreover, the proposed rates in the PSA are simply too high to be considered just and reasonable. For instance, the capacity charges in the first year of the PSA amount to $170.75/kW-year. Ex Gen-1 (Kuga Testimony) at 6. Specifically, the capacity charges are $20.50/kW-mo for the peak months of July and August, $15.25/kW-mo for June, September, and October, and $12/kW-mo for November through May. The capacity payment is paid on a portfolio of 7,100 MW of capacity. Id. at 5. Thus the capacity payments alone under the PSA, in the first year,

[16] PG&E declines to provide benchmark evidence regarding "buy-back" agreements executed in recent years in connection with sales of nuclear facilities in New York, or with fairly large hydroelectric portfolios elsewhere in the U.S.

amount to over $1.2 billion, and escalate to nearly $1.5 billion in year eleven. Ex. Gen-1-1.

FERC recently addressed another power sales agreement between affiliates in Ameren Energy Mktg. Co., 96 FERC ¶ 61,306 (2001) ("Ameren"). The contract is for a minimum of 350 MW of capacity and energy per hour from June 2001 through May 2002. In the affiliate contract at issue in Ameren, the maximum capacity charge is $4/kW-mo. The minimum capacity charge in PG&E's PSA exceeds that by 300 per cent.

The CPUC will address additional specific price terms in the PSA in testimony should this matter be set for hearing.[17]

Non-Price Terms and Conditions

The CPUC will address specific non-price terms and conditions in the proposed PSA in testimony should this matter be set for hearing, and expects to raise issues relating to water risk, availability, and dispatchability, among others.

At this juncture, however, one point should be made. The value of PG&E's Plan to Gen exceeds simply the revenues that Gen would receive under the PSA. Under the Plan, Gen will receive not only $52.29/MWh for twelve years, but in addition, Gen will receive virtually all of PG&E's electric generation assets for a fraction of their value. Gen will effectively pay reorganized PG&E $2.4 billion for PG&E's hydroelectric and nuclear assets. Application at 2 (upon receiving the generating facilities from PG&E "Gen will then transfer cash and notes to PG&E amounting to $2.4 billion").

[17] Witness Kuga's testimony at Ex Gen-1-33 and 44 is inconsistent with the chart at Ex Gen-1-3 as to Diablo Canyon availability. The testimony says that Diablo Canyon reliability figures are based on the most recent five years, while the chart includes lengthy 1994 outages. According to the chart, the average Diablo Canyon refueling outages over the last five years are less than the 42 days asserted in the testimony. For the years 1996-2001 the average is 38.8 days. For the years 1997-2001 the average is 37.2 days.

As we have shown elsewhere (see the CPUC's contemporaneous pleading in Docket Nos. EC02-31-000 et al.), Gen thus proposes to acquire the hydro and nuclear assets for less than PG&E has previously proposed as the market value for the hydro facilities alone. The market value of the hydro facilities was set at $2.8 billion in a settlement agreement proposed by PG&E, TURN, and other parties in CPUC Docket No. A.99-09-053, but which was not approved by the CPUC. PG&E subsequently proposed a market value of $4.1 billion for the hydroelectric facilities alone in CPUC Docket No. A.00-11-056.

These facts demonstrate that the PSA cannot appropriately be considered in isolation. Any substantive evaluation of the PSA must consider related issues including the value to Gen of obtaining the PG&E generating facilities for a fraction of their PG&E-proposed market value.

3. PG&E's Market Power Analysis is Woefully Insufficient

The Edgar line of cases requires an applicant in an affiliate sales case to make two separate market power showings. First, PG&E must demonstrate that "the benchmark evidence was not distorted by exercise of market power by the seller or its affiliates." Ocean State, 59 FERC at 62,333. In this regard, FERC is concerned that, "If the seller or any of its affiliates has exercised market power and thus kept prices high in the relevant market, the benchmark evidence would be skewed in favor of the seller and thereby allow the affiliated buyers to give an undue preference to the sellers." Ocean State, 59 FERC at 62,337. In this proceeding, FERC must address not only whether PG&E has exercised market power and thus skewed the benchmark evidence, but rather whether any party exercised market power in connection with the benchmark evidence. That is, a proper market analysis in this proceeding must consider whether the benchmark evidence was

skewed by the exercise of market power. As discussed above, there is no doubt that it was. Accordingly, the benchmark evidence is invalid, and cannot be used to support the PSA. Moreover, the issue of whether PG&E in fact exercised market power to the detriment of DWR's contracting options or decisions is an issue of fact which should (if the application is not rejected outright) be set for hearing, where the testimony submitted by PG&E on this subject may be subject to discovery and examination. For instance, PG&E's utilization of its generation resources may have affected the size of the "net short" position which DWR was attempting to cover through its contracting, and consequently the pricing and terms of the DWR contracts.

Second, if there has been a showing of no potential abuse of self-dealing or reciprocal dealing, FERC has found that market-based rates may be acceptable if the seller can also demonstrate that it lacks market power (or has adequately mitigated its market power), under familiar principles. Edgar, 55 FERC at 62,167. As PG&E requests acceptance of the PSA as market-based rate,[18] PG&E must satisfy this standard (although, set out above, PG&E has not demonstrated the lack of abuse of self-dealing).

PG&E currently possesses in excess of, and Gen proposes to acquire, 7,100 MW of generation. PG&E's contention that a supplier of such magnitude in frequently-constrained Northern California does not have market power fails the straight face test. Indeed, PG&E has been among the loudest voices arguing that suppliers with much smaller portfolios have both possessed and abused market power. See e.g. "Late Motion to Intervene and Protest of Pacific Gas & Electric Company and Southern California Edison Co." in Docket No. ER99-1722-004, filed April 3, 2001, at 7 ("because the

[18] Application at 14 n. 13.

premises on which Williams based its market power analysis are no longer valid, and because of the clear evidence that Williams can exercise market power in the WSCC, the Commission's review should lead to a suspension of Williams' market-based rate authority") and "Testimony of James Wilson for PG&E" in Docket No. EL00-95-000 at 10-16 and Figures 1, 2 and 5 (unrebutted testimony demonstrating that conditions in the California marketplace have permitted the exercise of market power, bidding without adequate competition by pivotal suppliers, and existence of Cournot pricing conditions during potentially 4000 hours in 2001).

Whether measured by the now-disregarded hub-and-spoke methodology or the Supply Margin Assessment ("SMA") screen established in AEP Power Marketing, Inc., 97 FERC ¶ 61,219 (2001) ("AEP"), PG&E indisputably possesses market power. At best, PG&E's showing—i.e. that it is a net purchaser rather than a net seller of electricity, and that its generation resources are currently required both by state and federal regulation to be devoted to native load—demonstrates that under current circumstances it has little incentive to exercise the market power it possesses. Application at 34-35. All this of course, will change should PG&E's Plan be implemented. Gen would become a stand-alone merchant seller with the largest single generation portfolio in California, and one of the largest generation portfolios in the country. Moreover, although the Gen application is a new market-based rate application submitted after the announcement of the SMA screen in AEP, PG&E has failed to perform an SMA analysis. Nor has PG&E submitted a hub-and-spoke analysis.

In sum, there can be no question that a supplier with a generation portfolio of the magnitude at issue here in Northern California possesses market power.

4. In Light of the Inadequacies of PG&E's Showing, and the Unique Aspects of the Proposed PSA, Only Cost-based Rates May be Accepted as Just and Reasonable

PG&E's Gen application wholly fails to satisfy the applicable standards necessary to support the rates in the proposed PSA, or any market-based rates. Due to the unique nature of both the proposed transaction and the magnitude of the generation portfolio supporting it, it is unlikely that PG&E could make a showing that satisfies the benchmark standards and effectively rebuts the presumption of self-dealing which must be drawn from the facts at issue here. Consequently, if this application is not dismissed outright, it should be set for hearing to determine lawful cost-based rates.

PG&E has asserted that other suppliers in California should be subject to cost-based ratemaking. For instance, in PG&E's Request for Rehearing of FERC's July 25, 2001 order (filed August 24, 2001), PG&E asserted that "cost of service rates [are] the only legally appropriate baseline given the fact that the California wholesale markets have been found to be unable to yield just and reasonable rates in all hours." Id. at 2. Similarly, PG&E's Rehearing Request states that, "As PG&E has previously stated in these dockets, absent a properly functioning market sellers should be permitted to collect no more than their cost of service, which would include a reasonable return on equity."

PG&E is entitled to no more. As the example set out above illustrates, a lawful cost-of-service rate for the portfolio supporting the PSA is on the order of 2.5 cents/kWh for 2003—roughly half of the rate proposed by PG&E.

5. At a Minimum, the November 30 Filings Should be Consolidated and Set for Hearing

PG&E's request to accept the PSA without a hearing must be denied. The CPUC has identified a multitude of legal and factual issues, and is prepared to address additional

issues at hearing. Moreover, the PSA cannot be evaluated or accepted in isolation. Any hearing must consolidate all of the November 30 Filings for a full consideration of the issues (should the applications not simply be rejected outright). FERC precedent supports setting related dockets of similar magnitude for hearing. See Northeast Utilities Company, 50 FERC ¶ 61,266 (1990) (establishing consolidated hearing procedures for several related proceedings proposed to implement a bankruptcy Plan of Reorganization for Public Service of New Hampshire). While PG&E has submitted testimony with its application, which it asserts supports acceptance, that testimony has not either been subject to discovery or tested by cross-examination.

C. PG&E Acknowledges that the True Justification for the Rates Proposed in the PSA is to Service the Debt to be Incurred by Gen Under the Plan

Further evidence that the rates proposed in the PSA are justified neither by truly comparable benchmark sales in a competitive environment, nor by any other measure of just and reasonable pricing, is provided in statements in the Application which reveal the true justification for the proposed rates. For instance, at 41-42 the Gen application states that "it would not be possible for Gen to assume this substantial portion of Exit Financing Debt without the PSA." That is, the rates in the PSA were determined by reference solely to the amount of financing which PG&E anticipates that Gen will incur after taking possession of the generating assets, and by the cash flow necessary to support that debt. If PG&E thought it could raise additional debt, the rates in the PSA would have been higher. If it had to finance the true market value of the facilities, the rates under the PSA would have to be substantially higher.

In fact, neither the income stream under the PSA nor the PSA itself are necessary for PG&E to emerge from bankruptcy. See e.g. Application at 42. Nor will PG&E's

Plan provide, as PG&E asserts, a quick route out of bankruptcy. The legal infirmities of PG&E's Plan are so extensive (and PG&E apparently so determined to press on with its Plan despite its legal infirmities) that years of litigation over the plan are almost inevitable. Rather, as discussed in the Joint Motion, the CPUC has formulated an Alternative Plan, to be outlined in greater detail to the Bankruptcy Court on February 13, which would enable PG&E to promptly emerge from bankruptcy with a minimum of litigation, without dismantling the company, and without the need to charge PG&E ratepayers the egregious rates proposed in the PSA.

IV. CONCLUSION

For the foregoing reasons, the CPUC requests that the application be dismissed. In the alternative, the CPUC protests the Gen application, requests consolidation of the November 30 Filings, and requests that FERC set the consolidated proceedings for hearing.

Respectfully submitted,

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January 29, 2002

EXHIBIT A

Gen	($Millions)			
	12/31/02	12/31/03	12/31/04	12/31/05
INCOME STATEMENT				
Total Operating Revenues		1471.5	1488.8	1504.9
Operating Expenses:				
Total Cost of Energy		95.7	89.5	93.8
M&O and A&G Costs		551.2	589.0	539.0
Depreciation		49.4	52.7	62.5
Property & Other Taxes		63.4	63.9	65.1
Total Operating Expenses		759.7	795.1	760.3
Operating Income		711.8	693.7	744.7
Total Interest Income		0.0	0.0	0.0
Total Interest Expense		194.1	188.6	183.1
Other Income		88.9	94.5	100.5
Pretax Income		606.7	599.6	662.0
Total Booked Income Taxes		245.8	242.9	268.3
Preferred Dividend Req		0.0	0.0	0.0
Total Earnings Avail for Common		360.9	356.7	393.7
BALANCE SHEET	12/31/02	12/31/03	12/31/04	12/31/05
Assets:				
Plant in Service	9489.6	9603.5	9703.4	9912.0
Accumulated Depr	(8640.3)	(8689.6)	(8742.5)	(8804.9)
Net Plant	849.3	913.8	960.9	1107.0
Construction Work In Progress	1.0	25.3	66.5	0.0
Other Noncurrent Assets	1572.2	1661.1	1755.7	1856.2
Total Long-term Assets	2422.5	2600.2	2783.1	2963.2
Current Assets:				
Short-term Investments (Net)	0.0	0.0	0.0	0.0
Accounts Receivable	199.3	181.4	183.5	185.5
Inventory - M&S	66.0	66.0	66.0	66.0
Other Current Assets	0.0	0.0	0.0	0.0
Total Current Assets	265.3	247.4	249.5	251.5
Deferred Charges	0.0	0.0	0.0	0.0

EXHIBIT G

DECLARATION OF DAVID R. EFFROSS

I, David R. Effross, declare as follows:

1. I am employed as a Public Utilities Regulatory Analyst by the California Public Utilities Commission ("CPUC"). In that capacity, I am responsible, among other things, for analyzing the technical and financial aspects of filings made by electric generation and transmission companies in order to determine whether those filings are sound, just and reasonable.

2. My educational background is as follows. I received an A.B. degree in Politics from Princeton University in 1987. I went on to study business management at the Sloan School of Management at the Massachusetts Institute of Technology, and received a Master of Science in Management degree in 1989. In 1994, I received a Mastère Specialisé en Politique et Gestion de l'Energie from the Ecole Nationale Supérieure du Pétrole et des Moteurs ("ENSPM") of the Institut Français du Pétrole ("IFP") in Reuil-Malmaison, France. I also hold a Master of Science degree in Energy Management and Policy, which I received in 1994 from the Center for Energy and the Environment of the University of Pennsylvania.

3. Prior to coming to the CPUC, I worked as an energy analyst for PWI Energy, an energy services company in Philadelphia, Pennsylvania.

4. I have thoroughly reviewed the filing made by Pacific Gas and Electric Company ("PG&E") in Nuclear Regulatory Commission Dockets 50-275 and 50-323, in which PG&E seeks approval for a license transfer for its Diablo Canyon Power Plant ("DCPP") Units 1 and 2 to a new generating company named

Electric Generation LLC ("Gen") and, in turn, to a new, wholly owned subsidiary of Gen named Diablo Canyon LLC ("Diablo").

5. The license for DCPP should not be transferred to Gen, because Gen's finances are highly questionable. It is uncertain that Gen will have the resources to carry out the critical plant maintenance and public safety-related functions that will enable DCPP to continue to meet the Commission's rigorous regulatory requirements.

6. As part of the Reorganization Plan it has submitted in connection with its bankruptcy filing, PG&E would divest most of its generation assets, including DCPP, to Gen, and would then enter into a Purchase & Sale Agreement ("PSA") to buy back the power output of DCPP for the next twelve years. This PSA has been submitted to the Federal Energy Regulatory Commission ("FERC") for approval. However, the rates proposed in the PSA are unjust and unreasonable, and FERC should accordingly not approve it.

7. Assuming that FERC properly determines that Gen should only be allowed to collect cost-based rates for DCPP, there will simply not be enough money coming in to Diablo both to operate the plant properly, and to service the debt to be incurred under the bankruptcy reorganization Plan. Under such circumstances, Gen and Diablo will be in no position to satisfy the requirement of the NRC's regulations that a non-utility applicant (such as Gen would be) must have reasonable assurance of obtaining the funds necessary to cover the plant's estimated operating costs.

8. Under the PSA, Gen proposes to sell all of the output of the (former) PG&E generation facilities, including DCPP, to Reorganized PG&E for an eleven year period at an unjust and unreasonable price, approaching double the rates PG&E would receive for the output of the facilities in the absence of the proposed transactions, and justified only by the need to service the unnecessary debt which Gen proposes to incur upon receipt of the facilities (the PSA includes a twelfth year for approximately half of the facilities' output).

9. The purported financial viability of Gen and Diablo depends wholly on FERC approval of the PSA. However, PG&E has wholly failed to meet FERC's standards applicable to power sales agreements between affiliates. Under the circumstances here, the applicable standards must be applied with extraordinary scrutiny. The PSA was not reached at arm's-length by entities with competing interests, but rather was developed by the same counsel working simultaneously for all the (affiliated!) parties, one of which is essentially non-existent.

10. At the heart of PG&E's application to FERC that seeks approval of the PSA is the contention that the rates in the proposed PSA are just and reasonable to Reorganized PG&E on the basis of a "benchmark" analysis conducted by PG&E's witness Meehan.

11. However, this "benchmark" analysis misses the mark. First, the rates in the proposed PSA must properly be evaluated not against other long-term power transactions, but rather against the rates which PG&E would receive for the

power output of DCPP and the other PG&E generation assets in the absence of the proposed Spin-Off. That is, the proposed PSA rates must be compared against the CPUC's rates for Utility Retained Generation. Second, even if it is appropriate to measure the proposed PSA against "comparable" wholesale transactions, PG&E's benchmark analysis fails to establish that the proposed PSA rates are just and reasonable. Third, PG&E fails to provide a cogent analysis of its market power. Consequently, PG&E fails to establish that the price and non-price terms and conditions of the PSA are just and reasonable, and that the PSA is not fatally tainted by self-dealing.

12. Under PG&E's proposal, Gen will sell the output of the electric generation facilities currently owned and operated by PG&E to Reorganized PG&E, which would in turn resell the facilities' output to its retail customers. However, in the absence of the transactions proposed in PG&E's Plan, PG&E would retain the electric generation assets that it proposes to transfer to Gen and to the subsidiaries of Gen, including, in this case, to Diablo Canyon LLC, and would continue selling the output of these facilities directly to its retail customers. Under either scenario, PG&E's retail customers will receive the same energy and Ancillary Services from the same facilities. Thus, the appropriate comparator against which to measure the PSA is the utility-retained generation ("URG") component of PG&E's retail rates. Under current California law and CPUC policy, such rates are determined on a traditional cost-of-service basis. The CPUC has expressly rejected PG&E's request to set its URG revenue requirement based

on market valuation rather than cost-of-service.

13. PG&E's witness Meehan states that the levelized price over the twelve-year period of the PSA is approximately $52.29/MWh. Elsewhere, PG&E asserts that the average price under the contract over the life of the contract is approximately 5.1 cents/kWh ($51/MWh). That the contract costs are unjust and unreasonable as to Reorganized PG&E (and to its retail ratepayers) is confirmed by PG&E's own numbers. In its Plan, PG&E projects revenues under the contract of approximately $1.5 billion annually. For calendar year 2003, PG&E projects revenues under the contract of $1,471,500,000. Based solely on the numbers presented by PG&E in its Plan, PG&E's revenue requirement based on traditional cost-of-service principles would be approximately $790.4 million for 2003—about half of PG&E's projected revenues. This translates to an illustrative rate of approximately 2.5 cents/kWh.

14. This calculation proceeds as follows: PG&E's Plan projects total operating expenses for Gen in 2003, including depreciation, of $759.7 million. From this figure is subtracted "other income" of $88.9 million, leaving net operating expenses of $670.8 million. To this is added a rate of return and taxes of $119.6 million, calculated utilizing PG&E's projected 2003 net plant shown in the Plan of Reorganization for the nuclear and hydro assets of $913.8 million and PG&E's rate of return grossed up for income tax authorized by the CPUC of 13.09%. This results in an illustrative cost-of-service revenue requirement for Gen, using PG&E's own figures, of $790.4 million for 2003.

15. The illustrative cost-of-service revenue requirement of $790.4 million is 53.7% of the proposed revenues PG&E would receive under the PSA in 2003 of $1,471.5 million. PG&E asserts that rates under the PSA in 2003 would be approximately 4.6 cents/kWh. Since, as PG&E asserts, revenues of $1,471.5 million equates to 4.6 cents/kWh on average, the cost-of-service revenue requirement is approximately 2.5 cents/kWh on average (.537 x 4.6 cents/kWh) for 2003.

16. While a rate of 2.5 cents/kWh is low compared to recent prices for gas-fired generation, the rate reflects the resource mix utilized for the PSA and PG&E's actual costs—not including the cost of unnecessarily borrowing over $2 billion. Moreover, PG&E's hydroelectric resources are highly depreciated, and PG&E's nuclear and hydro pumped storage resources, including DCPP, have been subject to accelerated depreciation during the transition period established under AB 1890, California's electric utility restructuring law. Ratepayers have paid several billion dollars of accelerated depreciation through California's Competitive Transition Charge, and would be losing a good portion of what they paid for under PG&E's Plan of Reorganization.

17. While these figures may be subject to some refinement, this illustration demonstrates that the PSA is grossly overpriced. If the PSA were approved as proposed, PG&E's ratepayers would make some $700 million in excess payments to Gen over and above the otherwise applicable rate for the same energy from the same facilities in 2003. Over the life of the PSA, the

overpayments approximate $8 billion.

18. PG&E's benchmark analysis, supported by the testimony of its witness Meehan, is invalid for a number of reasons. First, FERC requires a showing that there exists no potential abuse of self-dealing or reciprocal dealing. Second, if there has been a showing of no potential abuse of self-dealing or reciprocal dealing, FERC has found that market-based rates may be acceptable if the seller can also demonstrate that it lacks market power (or has adequately mitigated its market power).

19. As PG&E recognizes, the potential for self-dealing is present here, where the seller under the proposed PSA is essentially non-existent, and the terms and conditions of the PSA were developed by a single entity acting on behalf of both the putative seller and buyer. The risk of self-dealing is at its height in this transaction, in which the buyer under the proposed PSA would, if PG&E's Plan is confirmed, be stripped of all of its most valuable assets and the affiliate relationship then terminated.

20. In its unsuccessful attempt to demonstrate a lack of market power, PG&E contends that the relevant market is "the market for firm, long-term baseload and peaking capacity and energy for a duration of approximately 10-15 years with a start date expected near January 2003," and that the relevant region must be limited to suppliers which can deliver energy to PG&E. PG&E also contends that the relevant "contemporaneous" period is May 2000 through November 2001. By so attempting to confine the analysis, PG&E contends that

the appropriate benchmark sales are nine long-term contracts entered into by the California Department of Water Resources ("DWR") during 2001.

21. In confining its benchmark comparison to the DWR contracts, PG&E has sought to define as the relevant period precisely the same period in which the California wholesale electricity markets exhibited extreme dysfunction. PG&E itself has previously characterized this as a period of "massive market failure and upheaval in the regulatory regime that has led to billions of dollars in overcharges since May 2000." Similarly, PG&E has attempted to confine its benchmark comparison to DWR contracts, the negotiation of which PG&E has previously contended were subject to the exercise of market power, and as to which PG&E has contended FERC ought to order refunds.

22. PG&E's reliance on the DWR contracts for its benchmark analysis is fatal. The DWR contracts were negotiated and executed during a period of extreme exercise of market power, as FERC has acknowledged on repeated occasions. FERC has expressly recognized that the exercise of market power in the spot markets extended to the forward markets during the time period to which PG&E seeks to confine the analysis. Thus, the DWR contracts cannot be relied on to be a benchmark of market value in a competitive market, and cannot be relied on to demonstrate that the PSA reflects a competitive market value.

23. However, in connection with the PG&E bankruptcy reorganization Plan, it is inappropriate to consider only a geographic market centered on PG&E's service territory. First, as discussed above, an analytic limitation to contracts in

PG&E's California service territory focuses the analysis on an environment of acknowledged market power. Second, a broader geographic market is appropriate to consider in this case due to the nature of the PSA. The PSA is a long-term agreement with a delayed implementation date. Developed in 2001, it is proposed that the PSA run from January 2003 through 2014. The market for such contracts is decidedly national, not regional. That is, a seller need not be physically located in California in 2001 in order to provide power under a 12-year contract commencing in 2003. Because of the long duration and delayed implementation date, a seller would have sufficient time to build new facilities to satisfy all but the earliest segments of the twelve year period.

24. That the long-term market for electric generation is essentially national rather than regional is confirmed by an examination of regional pricing for forward electricity contracts. During the height of the recent California energy crisis, western forward prices were substantially higher than forward contracts at other national trading hubs—as much as an order of magnitude higher. Since FERC's summer 2001 orders restored a measure of stability to western markets, however, forward contract prices at various regional hubs have tended to converge. For instance, as of December 12, 2001 (when the notice was issued in this proceeding) the simple average of reported futures prices for calendar year 2002 were $30.66 for the California-Oregon border ("COB"), $34.25 for PJM, and $30.80 for CINergy. Longer-term prices should show similar convergence. As the relevant market for products similar to the PSA is a national rather than

regional market, and PG&E analyzes only a corrupted regional market, PG&E's benchmark analysis fails to satisfy the "relevant market" criterion on which a proper benchmark analysis must be based.

25. PG&E's benchmark analysis similarly fails to satisfy the "contemporaneous" criterion on which a proper benchmark analysis must be based. PG&E examined only contracts "entered into between May 2000 and the date of this Application." Meehan's analysis focuses on nine contracts entered into between February and August 2001 as his "comparison group." As noted above, this is precisely the period in which all energy transactions in the California markets were tainted with market power. It is patently unreasonable to consider only such contracts. Moreover, this period is not contemporaneous with the period in which the PSA was developed. PG&E filed its Plan with the Bankruptcy Court on September 20, 2001; however, the key event in this scenario is the order issued by FERC on June 19, 2001, which quickly restored a semblance of stability to the California markets. All of the contracts in witness Meehan's "comparison group" were either executed or had an executed letter of intent no later than June 22, 2001. That is to say, the negotiation of all of the comparison group contracts took place in the market power period. By the fall of 2001 when the PSA was developed, forward contract prices in California had already begun to converge with forward prices in regional markets across the country, at prices well below the prices in the PSA. PG&E has thus failed to examine any contemporaneous contracts in its benchmark analysis.

26. PG&E provides no justification for the period it has chosen. Certainly, PG&E makes no claim that that the roughly eighteen month period it has selected for examination represents the only, or even the most relevant, time period in which buyers seeking energy for the 2003-2014 period would have, or did, engage in negotiations.

27. The CPUC has no principled objection to a "contemporaneous" period of roughly eighteen months. But PG&E has disingenuously selected the precise 18 months in which the California market was at its most dysfunctional. The "contemporaneous" period selected by PG&E is invalid on its face, particularly when coupled with the limited geographical market also selected by PG&E. Any valid benchmark analysis must, if not be limited to, certainly include an examination of contracts executed during a period of relative market stability. Such a period could include, for instance portions of 1999 and 2000, and the latter third of 2001.

28. Benchmark evidence must also encompass "similar services." However, PG&E's benchmark analysis fails this requirement as well. The proposed PSA provides for capacity and energy from approximately 7,100 MW of hydroelectric and nuclear power plants. The size of the PSA alone disqualifies each of the purported "comparison group" contracts from consideration as comparable. Meehan admits that he must treat each of the comparison group contracts as "infinitely scalable" in order to make a comparison. Here, the facilities proposed to support the PSA are exclusively hydroelectric and nuclear

generating plants. However, the "comparison group" contracts, to the extent that they have any specific source of generation attached to them, are exclusively natural gas-fired units. The PSA is for some 7,100 MW. Only one of the comparison group contracts is within the same order of magnitude. The comparison group contracts are comparable in neither size nor technology to the PSA.

29. Moreover, the proposed rates in the PSA are simply too high to be considered just and reasonable. For instance, the capacity charges in the first year of the PSA amount to $170.75/kW-year. Specifically, the capacity charges are $20.50/kW-mo for the peak months of July and August, $15.25/kW-mo for June, September, and October, and $12/kW-mo for November through May. The capacity payment is paid on a portfolio of 7,100 MW of capacity. Thus the capacity payments alone under the PSA, in the first year, amount to over $1.2 billion, and escalate to nearly $1.5 billion in year eleven.

30. The value of PG&E's Plan to Gen exceeds the revenues that Gen would receive under the PSA. Under the Plan, Gen will receive not only $52.29/MWh for twelve years, but in addition, Gen will receive virtually all of PG&E's electric generation assets for a fraction of their value. Gen will effectively pay reorganized PG&E $2.4 billion for PG&E's hydroelectric assets and DCPP. Gen thus proposes to acquire the hydro and nuclear assets for less than PG&E has previously proposed as the market value for the hydro facilities alone. It follows from this that the PSA cannot appropriately be considered in isolation.

Any substantive evaluation of the PSA must also consider related issues, including the value to Gen of obtaining the PG&E generating facilities for a fraction of their PG&E-proposed market value.

31. An applicant in an affiliate sales case such as this one must make two separate market power showings. First, PG&E must demonstrate that the benchmark evidence was not distorted by exercise of market power by the seller or its affiliates. However, PG&E must also show whether any party exercised market power in connection with the benchmark evidence. That is, a proper market analysis must consider whether the benchmark evidence was skewed by the exercise of market power. As discussed above, there is no doubt that it was. Accordingly, the benchmark evidence is invalid, and cannot be used to support the PSA. Second, if there has been a showing of no potential abuse of self-dealing or reciprocal dealing, FERC has found that market-based rates may be acceptable if the seller can also demonstrate that it lacks market power (or has adequately mitigated its market power). Since PG&E requests acceptance of the PSA as market-based rate, PG&E must satisfy this standard (although, as is noted above, PG&E has not demonstrated the lack of abuse of self-dealing).

32. PG&E currently possesses in excess of, and Gen proposes to acquire, 7,100 MW of generation. PG&E's contention that a supplier of such magnitude in frequently constrained Northern California does not have market power fails the straight face test. Indeed, PG&E has been among the loudest voices arguing that suppliers with much smaller portfolios have both possessed

and abused market power.

33. PG&E indisputably possesses market power. At best, PG&E's showing -- i.e. that it is a net purchaser rather than a net seller of electricity, and that its generation resources are currently required both by state and federal regulation to be devoted to native load -- demonstrates that under current circumstances it has little incentive to exercise the market power it possesses. All this, of course, will change should PG&E's Plan be implemented. Gen would become a stand-alone merchant seller with the largest single generation portfolio in California, and one of the largest generation portfolios in the country. In sum, there can be no question that a supplier with a generation portfolio of the magnitude at issue here in Northern California possesses market power.

34. PG&E has wholly failed to satisfy the applicable standards necessary to support the rates in the proposed PSA, or any market-based rates. Due to the unique nature of both the proposed transaction and the magnitude of the generation portfolio supporting it, it is unlikely that PG&E could make a showing that satisfies the benchmark standards or effectively rebut the presumption of self-dealing which must be drawn from the facts at issue here.

35. PG&E has itself, however, asserted that other suppliers in California should be subject to cost-based ratemaking. For instance, in one FERC proceeding, PG&E has asserted that "cost of service rates [are] the only legally appropriate baseline given the fact that the California wholesale markets have been found to be unable to yield just and reasonable rates in all hours." Similarly,

PG&E has stated that, "As PG&E has previously stated in these dockets, absent a properly functioning market sellers should be permitted to collect no more than their cost of service, which would include a reasonable return on equity."

36. PG&E is entitled to no more than it has asserted other suppliers to be entitled to. As the above example illustrates, a lawful cost-of-service rate for the portfolio supporting the PSA is on the order of 2.5 cents/kWh for 2003 -- roughly half of the rate proposed by PG&E.

37. The rates in the PSA were determined by reference solely to the amount of financing which PG&E anticipates that Gen will incur after taking possession of the generating assets, including DCPP, and by the cash flow necessary to support that debt. If PG&E thought it could raise additional debt, the rates in the PSA would have been higher. If it had to finance the true market value of the facilities, the rates under the PSA would have to be substantially higher.

38. In fact, neither the income stream under the PSA nor the PSA itself is necessary for PG&E to emerge from bankruptcy. Nor will PG&E's Plan provide, as PG&E asserts, a quick route out of bankruptcy. Rather, the CPUC has formulated an Alternative Plan, to be outlined in greater detail to the Bankruptcy Court on February 13, 2002, which would enable PG&E to promptly emerge from bankruptcy with a minimum of litigation, without dismantling the company, and without the need to charge PG&E ratepayers the egregious rates proposed in the PSA.

39. For all the foregoing reasons, Gen cannot by any stretch of the

imagination be deemed to satisfy the financial responsibility requirement of the NRC's regulations. Moreover, there is a reasonable alternative plan, sponsored by the CPUC, under which PG&E will continue to operate DCPP under cost-of-service rates, that does provide reasonable assurance of more than adequate funding for all of DCPP's plant operational and maintenance-related needs, thereby assuring protection of public health and safety. For all these reasons relating to the lack of financial responsibility of the proposed transferee of DCPP, the NRC should reject PG&E's request for a license transfer.

I declare under penalty of perjury that the foregoing is true and correct to the best of my knowledge.

Executed this 5th day of February, 2002, at San Francisco, California

David R. Effross

EXHIBIT H

New terror attacks on U.S. predicted

Nuclear reactor seen as possible target

By Thomas Frank
NEWSDAY

WASHINGTON — Officials stepped up warnings Thursday of a potential new terrorist attack on the United States, possibly against a nuclear power plant or water facility, or involving nuclear weapons.

The warnings came as Defense Secretary Donald Rumsfeld said attacks against the nation "could grow vastly more deadly" than the Sept. 11 hijackings that killed more than 3,000.

The new concerns were spurred by the discovery of documents, diagrams and computers in Afghanistan showing al-Qaida's apparent interest in producing a nuclear weapon or in possibly attacking a nuclear reactor or other major facility.

The CIA said in a report Wednesday that it had found "rudimentary diagrams of nuclear weapons inside a suspected al-Qaida safehouse in Kabul." The threat of terrorists using chemical, biological, radiological and nuclear "appears to be rising — particularly since the Sept. 11 attacks," the CIA added.

An FBI bulletin Wednesday said that al-Qaida members apparently were studying water-supply systems and sewage

Please see **Attack**, NEWS-9

HILLERY SMITH GARRISON — Associated Press

DEFENSE Secretary Donald Rumsfeld, accompanied by Gen. Tommy Franks, issues terror warning Thursday during a news conference in Washington.

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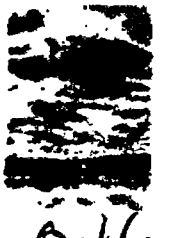
WEATHER

Forecast
Partly cloudy, cool
High: mid 50s.
Low: lower 40s

Yesterday
High: Alameda, 55
Low: Berkeley, 38



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Oakland Tribune

Exhibit G-2 11/02

Attack: FBI alerted police Jan. 16 of possible attacks

Continued from NEWS-1

plants in the United States. Someone indirectly linked to Osama bin Laden showed an apparent interest in the design of dams, the FBI added, relying on information from that person's computer.

And the Nuclear Regulatory Commission reportedly warned the nation's 103 nuclear power plants of a possible airplane attack, but an FBI official said the NRC relied on "dated information (that) is uncorroborated." The FBI has said the informant who described the purported attack is an al-Qaida operative who has not been credible in the past, a source said.

But the Office of Homeland Security said Thursday that the FBI had alerted local police on Jan. 16 of possible attacks on energy facilities, reservoirs and dams, nuclear and gas facilities and storage sites for highly enriched uranium, the key ingredient in nuclear weapons.

Homeland Security spokesman Gordon Johndroe said he believed it was the first alert issued specifically covering such facilities, although four general alerts have been made since October, most recently on Jan. 2.

Reports of new threats came after President Bush's warning Tuesday in his State of the Union address about more terrorist attacks. Bush said U.S. officials found "diagrams of nuclear power plants and public water facilities, detailed instructions for making chemical weapons, surveillance maps of American cities and thorough descriptions of landmarks in America and throughout the world."

FBI Director Robert Mueller said Thursday that the nation is "still in a high state of alert and will be for some time."

Distributed by the Los Angeles Times-Washington Post News Service.

Strike threat looms at refineries

BAY CITY NEWS

MARTINEZ — As a strike deadline that would affect oil refineries nationwide approaches, union representatives held a news conference in Martinez Thursday to announce their positions if a contract doesn't get signed.

Negotiations between unions and the oil industry are taking place at the national level in Nashville, Tenn.

Negotiations are also taking place at the local level, where the unions say the refineries should increase the national baseline offerings to the 2,500 union refinery workers in the Bay Area due to the high cost of living in the region.