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12 PACIFIC GAS AND ELECTRIC COMPANY

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

16 In re
17 PACIFIC GAS AND ELECTRIC
18 COMPANY, a California corporation,
19 Debtor.

Case No. 01-30923 DM

Chapter 11 Case

Date: September 16, 2003
Time: 1:30 p.m.
Place: 235 Pine Street, 22nd Floor
San Francisco, California
Judge: Hon. Dennis Montali

20 Federal I.D. No. 94-0742640

21 NOTICE OF MOTION AND MOTION OF PACIFIC GAS AND
22 ELECTRIC COMPANY FOR ORDER AUTHORIZING USE OF
23 CASH COLLATERAL TO MAINTAIN WORKERS' COMPENSATION
24 COLLATERAL IN COMPLIANCE WITH APPLICABLE LAW;
25 MEMORANDUM OF POINTS
26 AND AUTHORITIES IN SUPPORT THEREOF

27 [SUPPORTING DECLARATION OF HUDSON T. MARTIN FILED SEPARATELY]
28

BKRP01

HOWARD
RICE
NEMEROVSKI
CANADY
FALK
& RABKIN
A Professional Corporation

1 MEMORANDUM OF POINTS AND AUTHORITIES

2 I.

3 FACTUAL BACKGROUND¹

4
5 A. General Background

6 PG&E is an investor-owned utility providing electric and gas services to millions
7 of California residents and businesses. On April 6, 2001, (the "Petition Date") PG&E filed a
8 voluntary petition under Chapter 11 of the Bankruptcy Code. PG&E continues to manage
9 and operate its business and property as a debtor in possession pursuant to Sections 1107 and
10 1108 of the Bankruptcy Code.² No trustee has been appointed.

11 PG&E, an employer of thousands of employees, has been granted a Certificate of
12 Consent to Self-Insure (the "Certificate") by the State of California Department of Industrial
13 Relations (the "State"). Pursuant to the Certificate, PG&E self-insures its workers'
14 compensation liabilities in California. Self-insurance is the lowest cost and most efficient
15 method of handling these obligations. As a condition of self-insurance, PG&E must provide
16 certain collateral with the State to cover the future liabilities of the self-insured program in
17 the event that PG&E defaults on its obligations to pay benefits. The current collateral
18 requirement is \$347,686,313. PG&E currently has five surety bonds totaling \$365,000,002
19 in place to satisfy this requirement. Collateral requirements are adjusted annually. Since the
20 filing of the Chapter 11 case, PG&E has maintained the required level of security by posting
21 surety bonds as collateral.

22 On July 16, 2003, PG&E received notification from the State (the "July 16, 2003
23 Letter") that the issuer of one of the surety bonds posted as collateral for such future claims
24 has failed to maintain an acceptable credit rating as required by California Code of

25
26 ¹The evidentiary basis and support for the facts set forth in this Motion are contained in
the Martin Declaration filed concurrently herewith.

27 ²Unless otherwise indicated, all statutory references in this Motion are to the United
28 States Bankruptcy Code (Title 11 of the United States Code).

1 Regulations, Title 8, Section 15210(h). Pursuant to Section 15210(h), PG&E is required to
2 replace that collateral within 60 days of the July 16, 2003 notification date or risk revocation
3 of the Certificate. In order to provide such financial assurances, PG&E will need to use
4 "cash collateral" within the meaning of Section 363 of the Bankruptcy Code by providing
5 cash or cash equivalents to replace the \$60 million surety bond that no longer meets the
6 State's financial strength requirements. PG&E seeks authority from the court to use
7 \$42,686,311 of cash collateral for this purpose as is necessary to comply with applicable
8 State regulations and with California Labor Code §3701.

9 Acceptable forms of collateral as defined in California Labor Code §3701 include
10 cash, securities, surety bonds, or irrevocable letters of credit. While prior to the filing of the
11 Chapter 11 case, PG&E typically provided such financial assurances in the form of surety
12 bonds, it no longer has the ability to obtain such bonds on an unsecured basis. Procedures of
13 using securities for collateral are complex, costly and compliance with the 60 day deadline
14 would be difficult. Posting letters of credit is costly and would require time consuming
15 procedures. PG&E has determined that under the circumstances, it will be required to post
16 cash for the required security as it believes that cash represent the most cost-effective and
17 readily available method for providing the necessary financial assurances.

18 BNY Western Trust Company is the indenture trustee for certain mortgage bonds
19 issued by PG&E (the "Indenture Trustee"), holding a lien on substantially all of PG&E's real
20 and personal property assets for the benefit of the mortgage bondholders. PG&E has had
21 discussions with the Indenture Trustee concerning this Motion and the use of cash collateral
22 in the manner described above. The Indenture Trustee has indicated that it has no objection
23 to PG&E's filing of the Motion, but at the same time, the Indenture Trustee has reserved the
24 right to object to the use of cash collateral and to require that PG&E carry its burden of
25 establishing that the Indenture Trustee's interest are adequately protected.

26
27 **B. California Code of Regulations, Title 8, Section 15210 (h)**

28 **California Code of Regulations, Title 8, Section 15210 (h) was amended,**

1 effective May 30, 2003. The main purpose of this amendment was to require prompt
2 compliance with collateral requirements with respect to self insurance Certificates. The law
3 provides that a Certificate may be summarily revoked without a hearing for failure by a self-
4 insured employer to maintain the required amount of collateral for a 60-day period. Here,
5 the 60-day period commenced with the July 16, 2003 Letter due to the failure of an issuer of
6 one of the surety bonds posted as collateral for future workers' compensation claims to
7 maintain an acceptable credit rating as required by California Code of Regulations, Title 8,
8 Section 15210(h). Accordingly, PG&E must provide adequate replacement security on or
9 before September 15, 2003.

10
11 II.

12 **PG&E SHOULD BE AUTHORIZED TO ENTER INTO THESE**
13 **FINANCIAL ASSURANCE ARRANGEMENTS PURSUANT TO**
14 **BANKRUPTCY CODE SECTION 364**

15 PG&E seeks authority to post the cash collateral required by applicable state law,
16 as discussed above, under California Code of Regulations, Title 8, Section 15210(h).
17 Although the transaction for which PG&E seeks approval is not, strictly speaking, the
18 "obtaining of credit" or "the incurring of debt" secured by a lien, as described in Section
19 364(d) of the Bankruptcy Code, PG&E believes that this transaction, which involve the
20 collateralization of obligations under relevant state law, is analogous to secured credit
21 transactions under Section 364. PG&E also seeks authorization for these transactions under
22 Section 363(b)(1), as transactions outside the ordinary course of business, as explained more
23 fully in Section III. below.

24 Bankruptcy Code Section 364(d)(1) provides as follows:

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

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

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

1 Thus, the only statutory prerequisites for obtaining credit on a senior secured
2 basis is that the debtor be unable to obtain such credit otherwise, and that there be adequate
3 protection for the existing lienholder. This test is clearly satisfied in this case. As discussed
4 above, PG&E is required under existing law to provide the financial assurances, in the form
5 of cash collateral or other credit assurance, and is unable to provide alternative arrangements
6 (in the form of unsecured surety bonds, securities or letters of credit).

7 Further, the only existing potential lienholder, the Indenture Trustee, is fully
8 secured and adequately protected by a substantial equity cushion, as has been repeatedly
9 demonstrated in previous motions filed by PG&E in this case. As set forth in the Debtor's
10 Operating Report filed with this Court (Docket No. 13037), as of May 31, 2003, the
11 Debtor's total reported assets exceeded \$26 billion (including cash on hand of approximately
12 \$3.5 billion), while the Debtor's outstanding obligations under the mortgage bond indenture,
13 which are secured by substantially all of the Debtor's assets, aggregate approximately \$3
14 billion.

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

1 In this case, as discussed above, PG&E seeks to provide cash collateral to comply
2 with applicable state laws and regulations. Such compliance is clearly in the best interests of
3 the estate and is not detrimental to parties in interest in this case. Accordingly, the Court
4 should authorize PG&E to post cash collateral under Section 364.

5
6 III.

7 PG&E SHOULD BE AUTHORIZED TO ENTER INTO THE
8 PROPOSED FINANCIAL ASSURANCE ARRANGEMENTS
9 UNDER SECTION 363(b)(1) OF THE BANKRUPTCY CODE

10 The maintenance of the collateral to secure the Certificate for which PG&E is
11 seeking authority to post cash collateral, is clearly within the ordinary course of PG&E's
12 business. To the extent that the fact that PG&E previously provided such financial
13 assurances in the form of surety bonds, but no longer has the ability to obtain such bonds on
14 an unsecured basis transforms the transactions into ones that require Bankruptcy Court
15 approval, PG&E submits that it should be authorized to enter into such transactions pursuant
16 to Section 363(b)(1) of the Bankruptcy Code.

17 In determining whether to authorize a transaction under Section 363(b)(1), courts
18 require a debtor to show that a sound business purpose justifies such actions, applying the
19 "business judgment" test. See, e.g., Stephens Indus., Inc. v. McClung, 789 F.2d 386, 389-90
20 (6th Cir. 1986); Comm. of Equity Sec. Holders v. Lionel Corp. (In re Lionel Corp.), 722
21 F.2d 1063, 1071 (2d Cir. 1983); see also 3 Lawrence P. King, Collier on Bankruptcy
22 §363.02[1][g] (15th ed. rev. 1998).

23 The burden of establishing a valid business purpose for a transaction outside the
24 ordinary course of business falls upon the debtor. See In re Lionel Corp., 722 F.2d at 1070-
25 71. Once the debtor has articulated a rational business justification, however, a presumption
26 attaches that the decision was made on an informed basis, in good faith and in the honest
27 belief that the action was in the best interest of the debtor. See, e.g., Official Comm. of
28 Subordinated Bondholders v. Integrated Res., Inc. (In re Integrated Res., Inc.), 147 B.R. 650,
656 (S.D.N.Y. 1992) (citing Smith v. Van Gorkom, 488 A.2d 858, 872 (Del. 1985)).

1 As discussed in detail above, sound business justifications exist for PG&E to
2 enter into the proposed cash collateral arrangement, and such arrangement is now required of
3 PG&E under applicable state laws and regulations. Moreover, as a debtor in possession,
4 PG&E is required to comply with applicable state law in the operation of its property,
5 pursuant to 28 U.S.C. Section 959(b).

6
7 IV.

8 CONCLUSION

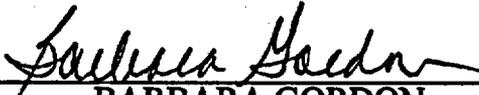
9 For all of the foregoing reasons, PG&E respectfully requests that this Court make
10 and enter its order:

- 11 1. Granting the Motion;
- 12 2. Authorizing PG&E to use cash collateral in order to provide financial
13 assurances as described in the Motion in amounts not to exceed \$42,686,311 in order for
14 PG&E to comply with applicable state laws and regulations; and
- 15 3. Granting such other relief as the Court deems just and appropriate.

16 DATED: August 19, 2003

Respectfully,

17 HOWARD, RICE, NEMEROVSKI, CANADY,
18 FALK & RABKIN
A Professional Corporation

19
20 By: 

BARBARA GORDON

21 Attorneys for Debtor and Debtor in Possession
22 PACIFIC GAS & ELECTRIC COMPANY