

1 JAMES L. LOPES (No. 63678)
2 GARY M. KAPLAN (No. 155530)
3 HOWARD, RICE, NEMEROVSKI, CANADY,
4 FALK & RABKIN
5 A Professional Corporation
6 Three Embarcadero Center, 7th Floor
7 San Francisco, California 94111-4024
8 Telephone: 415/434-1600
9 Facsimile: 415/217-5910

6 Attorneys for Debtor and Debtor in Possession
7 PACIFIC GAS AND ELECTRIC COMPANY

8 UNITED STATES BANKRUPTCY COURT
9 NORTHERN DISTRICT OF CALIFORNIA
10 SAN FRANCISCO DIVISION

11 In re

12 PACIFIC GAS AND ELECTRIC
13 COMPANY, a California corporation,

14 Debtor.

15 Federal I.D. No. 94-0742640

Case No. 01-30923 DM

Chapter 11 Case

Date: February 9, 2004

Time: 1:30 p.m.

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

Judge: Hon. Dennis Montali

17
18 NOTICE OF MOTION AND DEBTOR'S MOTION FOR ORDER APPROVING
19 SETTLEMENT AGREEMENT AMONG THE DEBTOR, ENRON CANADA CORP.,
20 ENRON ENERGY MARKETING CORP., ENRON ENERGY SERVICES, INC., ENRON
21 NORTH AMERICA CORP. AND ENRON POWER MARKETING, INC.;
22 SUPPORTING MEMORANDUM OF POINTS AND AUTHORITIES

23 [DECLARATION OF FONG WAN IN SUPPORT THEREOF FILED SEPARATELY]
24
25
26
27
28

TABLE OF CONTENTS

	Page
1	
2	
3	
4	
5	
6	
7	
8	
9	
10	
11	
12	
13	
14	
15	
16	
17	
18	
19	
20	
21	
22	
23	
24	
25	
26	
27	
28	
NOTICE OF MOTION AND MOTION	1
MEMORANDUM OF POINTS AND AUTHORITIES	3
I. FACTUAL BACKGROUND	3
A. Filing Of The Bankruptcy Cases By PG&E And The Enron Parties	3
B. The Enron Parties' Claims Filed In The PG&E Bankruptcy Case	3
C. The PG&E Claims Filed In The Enron Bankruptcy Cases	5
D. The Settlement Agreement	7
1. Allowed Retail DA Credits Claim And Release Of PG&E Claims Against EES, EEM And Related Guarantee Claims	8
2. Allowed Wholesale Power & Gas Claim And Release Of PG&E Claims Against ENA And EPMI And Related Guarantee Claims	10
3. Limitation On EES And EEM Recovery On CRS Claims	11
E. Mutual Releases	12
F. Retail Settlement Termination Option And Escrow Agreement Provisions	12
G. Other Provisions Of The Settlement Agreement	15
II. ARGUMENT	15
A. Standard For Approval Of A Compromise Under Bankruptcy Law.	15
B. The Probability of Success is Uncertain.	16
C. Since The Settlement Agreement Primarily Involves Resolution Of The Enron Parties Claims, The Difficulty Of Collection Factor Is Less Relevant; In Any Event, The Settlement Agreement Reduces The Risk Of PG&E Not Recovering On The PG&E Claims By Effectively Providing For Recovery Through Reduction In The Amount Of The Enron Parties Claims	16
D. The Disputed Issues Are Complex And Continued Litigation Would Entail Unnecessary Expense, Inconvenience and Delay.	17

TABLE OF CONTENTS

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25
26
27
28

Page

E. The Settlement Agreement Would Benefit The Estate And Its Creditors.

18

CONCLUSION

19

HOWARD
RICE
NEMEROVSKI
CANADY
FALK
& RABKIN
A Professional Corporation

TABLE OF AUTHORITIES

Page(s)

Cases

Martin v. Kane (In re A & C Properties), 784 F.2d 1377 (9th Cir. 1986)	15, 16
Woodson v. Fireman's Fund Ins. Co. (In re Woodson), 839 F.2d 610 (9th Cir. 1988)	15

HOWARD
RICE
NEMEROVSKI
CANADY
FALK
& RABKIN
A Professional Corporation

1 contains broad mutual releases by the parties, while expressly preserving certain matters,
2 including all claims of PG&E against the Enron Parties (except EES and EEM) and their
3 affiliates relating to issues raised in Federal Energy Regulatory Commission ("FERC")
4 proceedings regarding alleged violations of the Federal Power Act or Natural Gas Act,
5 dysfunctions or potential manipulation of the Western gas or electric markets by Enron, its
6 Affiliates and others, and all claims of PG&E arising from transactions in the markets
7 operated or administered by the PX and/or the CAISO.

8 This Motion is brought pursuant to Rule 9019 of the Federal Rules of Bankruptcy
9 Procedure and is based on the grounds that the proposed Settlement Agreement is fair and
10 equitable and in the best interests of the bankruptcy estate. This Motion is based on this
11 Notice Of Motion And Motion, the accompanying Memorandum Of Points And Authorities
12 in support thereof, the supporting Declaration Of Fong Wan ("Wan Decl.") submitted
13 concurrently herewith, the record of this case, and any admissible evidence presented to the
14 Court prior to or at the hearing on this Motion.

15 **PLEASE TAKE FURTHER NOTICE** that pursuant to Rule 9014-
16 1(c)(2)**Error! Bookmark not defined.** of the Bankruptcy Local Rules of the United States
17 District Court for the Northern District of California, any opposition to the Motion and the
18 relief requested herein must be filed with the Bankruptcy Court and served upon appropriate
19 parties (including counsel for PG&E) at least five (5) days prior to the scheduled hearing
20 date. If there is no timely objection to
21 the requested relief as described in this paragraph, the Court may enter an order granting
22 such relief without further hearing.

23 \\\
24 \\\
25 \\\
26 \\\
27 \\\
28 \\\

HOWARD
RICE
NEMEROVSKI
CANADY
BALK
& RABKIN
A Professional Corporation

1 MEMORANDUM OF POINTS AND AUTHORITIES³

2 I.

3 FACTUAL BACKGROUND

4 A. Filing Of The Bankruptcy Cases By PG&E And The Enron Parties

5 On April 6, 2001 (the "PG&E Petition Date"), PG&E filed a voluntary petition
6 for relief under Chapter 11 of the Bankruptcy Code commencing the above-captioned case
7 (the "PG&E Bankruptcy Case") in the above-captioned Court (the "PG&E Bankruptcy
8 Court"). PG&E is a debtor in possession and is operating its business pursuant to 11 U.S.C.
9 §§1107 and 1108.

10 Beginning on December 2, 2001 (the "Enron Petition Date"), the Enron Parties
11 (except for ECC) and certain other direct and indirect affiliates of Enron Corp. ("Enron")
12 filed voluntary petitions for relief under Chapter 11 of the Bankruptcy Code, which cases are
13 being jointly administered in Case No. 01-16034 (AJG) (the "Enron Bankruptcy Cases")
14 pending before the United States Bankruptcy Court for the Southern District of New York
15 (the "Enron Bankruptcy Court"). The Enron Parties (except for ECC) are debtors in
16 possession operating their respective businesses pursuant to 11 U.S.C. §§1107 and 1108.

17 As discussed in greater detail below, PG&E and the Enron Parties, respectively,
18 have each filed certain claims in the other party's bankruptcy case(s) arising from various
19 contracts, agreements, guarantees, transactions, proceedings, disputes and other
20 circumstances, including those listed on Schedule C attached to the Settlement Agreement.

21 B. The Enron Parties' Claims Filed In The PG&E Bankruptcy Case

22 The Enron Parties have filed certain claims in the PG&E Bankruptcy Case, as
23 listed on Schedule A attached to the Settlement Agreement (the "Enron Parties Claims"),
24 including the following:

- 25 (1) Claim No. 8878 of ENA for (i) \$24,138,010 under a certain gas agreement
26 and (ii) \$74,190,183 under a certain swap agreement.
27 (2) Claim No. 8879 of EPMI for (i) an unliquidated amount estimated at

28 ³The evidentiary basis and support for the facts set forth in this Motion are contained
in the Wan Declaration filed concurrently herewith.

1 approximately \$30 million based on the purchase of electricity or ancillary
2 services by PG&E in markets operated by the PX or the CAISO; (ii) an
3 unliquidated amount estimated at \$33,800,000 on account of CAISO
4 underscheduling penalty revenues; (iii) \$186,000 on account of power sold under
5 certain block forward contracts "commandeered" by the State of California; and
6 (iv) not less than \$133,777,021 on account of the loss of certain collateral placed
7 with the PX.

8 (3) Claim No. 8880 of ECC for \$22,054,852 under a certain gas agreement.

9 (4) Claim No. 8881 of EES for \$239,920,010 on account of certain direct access
10 energy credits ("DA Credits") with respect to former direct access customers of
11 EES or EEM in PG&E's service territory as to which EES or EEM (as the case
12 may be) acted as an energy service provider ("ESP")

13 (5) Claim No. 8882 of EEM for \$164,029,412 on account of DA Credits.

14 (6) Claim No. 13378 of EES (filed as an amendment to Claim No. 8881) for an
15 unliquidated amount estimated at \$437,590,461 on account of "Customer CRS
16 Claims"⁴ based on certain "direct access cost responsibility surcharges" imposed
17 by the California Public Utilities Commission ("CPUC") on certain former direct
18 access customers of EES and EEM.

19 (7) Claim No. 13379 of EEM (filed as an amendment to Claim No. 8882) for an
20 unliquidated amount estimated at \$73,393,160 on account of Customer CRS
21 Claims.

22 PG&E has filed objections to each of the Enron Parties Claims (collectively, the
23 "Objections"). Other than certain portions of EPMI's Claim No. 8879 (designated as items
24 (2) (ii), (iii) and (iv) above) which were previously disallowed by order of the PG&E
25 Bankruptcy Court, each of the Objections currently remains unresolved.⁵ Pursuant to the
26 Settlement Agreement, the currently remaining Enron Parties Claims aggregating
27 approximately \$1.035 billion (items (1), (3), (4), (5) (6) and (7) above) will be allowed in a
28 maximum aggregate amount of \$345 million, which amount can decrease to approximately
\$284 million (or even less), based on certain adjustments, as discussed in greater detail
below. The remaining portions of EPMI's Claim No. 8879 (item (2) above) are not resolved
pursuant to the Settlement Agreement, nor are Claim Nos. 13378 and 13379 of EES and
EEM, respectively, although the latter two claims are limited to an aggregate recovery of

⁴Capitalized terms not defined herein have the meaning ascribed to them in the Settlement Agreement.

⁵Hearings on the Objections with respect to items (1), (3), (6) and (7), which have been continued multiple times based on ongoing settlement discussions, are currently scheduled for February 26, 2004 at 1:30 p.m. Resolution of the Objections with respect to items (2), (4) and (5) is dependent on ongoing proceedings in non-bankruptcy fora, including the Federal Energy Regulatory Commission and CPUC.

1 \$30 million, which is reflected in the amounts stated in the immediately preceding sentence.

2 **C. The PG&E Claims Filed In The Enron Bankruptcy Cases**

3 PG&E has filed certain claims in the Enron Bankruptcy Cases, as set forth on
4 Schedule B attached to the Settlement Agreement (the "PG&E Claims"), including the
5 following:

6 (1) Claim No. 5251 against National Energy Production Corporation for \$298.94
7 on account of natural gas supply.

8 (2) Claim No. 12547 against EEM for at least \$1,984,163.00 on account of
9 terminated transactions under a certain gas agreement.

10 (3) Claim No. 12562 against EES for at least \$20,637,886.74 on account of
11 transmission and distribution charges under a certain ESP agreement.

12 (4) Claim No. 12563 against EES for an amount to be determined arising out of
13 acts in Western energy markets resulting in overcharges.

14 (5) Claim No. 12564 against Enron Natural Gas Marketing Corp. in an amount to
15 be determined arising out of acts in Western energy markets resulting in
16 overcharges.

17 (6) Claim No. 12572 against Enron Capital & Trade International Corp. in an
18 amount to be determined arising out of acts in Western energy markets resulting
19 in overcharges.

20 (7) Claim No. 12573 against EPMI for at least \$86,353,173.00 on account of
21 terminated transactions under a certain electricity agreement.

22 (8) Claim No. 12574 against EEM for at least \$16,969,631.00 on account of
23 transmission and distribution charges under a certain ESP agreement.

24 (9) Claim No. 12575 against EES for at least \$981,293.00 on account of
25 terminated transactions under a certain gas agreement.

26 (10) Claim No. 12576 against Enron in an amount to be determined arising out of
27 acts in Western energy markets resulting in overcharges.

28 (11) Claim No. 12577 against EES for at least \$466,179.93 for gas storage and
transmission services under a certain gas agreement.

(12) Claim No. 12578 against ENA for at least \$10,578,303.11 for terminated
transactions under a certain gas agreement.

(13) Claim No. 12579 against EES for at least \$11,762.81 on account of charges
under a certain ESP agreement.

(14) Claim No. 12580 against EEM for at least \$34,354.00 on account of charges
under a certain ESP agreement.

(15) Claim No. 12581 against EEM for at least \$4,027.00 for gas storage and
transmission services under a certain gas agreement.

(16) Claim No. 12931 against Enron in an amount to be determined on account of
FERC refund proceedings.

(17) Claim No. 12932 against EEM for an amount to be determined arising out of
acts in Western energy markets resulting in overcharges.

1 (18) Claim No. 12935 against Enron for at least \$10,739,398.32 on account of a
certain guarantee of ENA obligations.

2 (19) Claim No. 12936 against Enron for at least \$22,097,124.48 on account of a
3 certain guarantee of EES obligations.

4 (20) Claim No. 12937 against EPMI for at least \$62,494,044.26 on account of
FERC refund proceedings.

5 (21) Claim No. 12938 against Enron for at least \$45,000,000 on account of a
certain guarantee of EPMI obligations.

6 (22) Claim No. 12939 against EES for an amount to be determined on account of
FERC refund proceedings.

7 (23) Claim No. 12948 against ENA in an amount to be determined arising out of
8 acts in Western energy markets resulting in overcharges.

9 (24) Claim No. 13361 against EPMI in an amount to be determined arising out of
acts in Western energy markets resulting in overcharges.

10 (25) Claim No. 22698 against EEM in an amount to be determined related to
erroneous metering data.

11 (26) Claim No. 22699 against EES in an amount to be determined related to
erroneous metering data.

12 (27) Claim No. 22700 against EPMI in an amount to be determined related to
13 erroneous metering data.

14 Enron and the Enron Parties have indicated their objections to certain of the
15 PG&E Claims, although they have not filed any formal objections to any of the PG&E
16 Claims. Pursuant to the Settlement Agreement, all of the PG&E Claims against EES and
17 EEM, certain of the PG&E Claims against the other Enron Parties, and the PG&E Claims
18 against Enron based on the guarantee of such Claims (items (2), (3), (4), (7), (8), (9), (11),
19 (12), (13), (14), (15), (17), (18), (19) (21) and (22), above), which currently aggregate
20 approximately \$73 million on their face,⁶ will be released, with certain exceptions (e.g.,
21 PG&E can continue to pursue recovery with respect to items (2) and (7) against parties other
22 than Enron and its Affiliates, including certain surety bonds and letters of credit; and PG&E
23 can continue to pursue its guarantee claim against Enron (item 21) with respect to claims
24

25 ⁶This amount reflects PG&E's receipt of payment on a judgment (as to which an
26 appeal is currently pending) in the amount of approximately \$65 million (including pre-
27 judgment interest) based on letters of credit securing EPMI's obligations with respect to item
28 (7). This amount also eliminates "double counting" for guarantee claims against Enron for
which the underlying liability is already included, and does not take into account any
amounts subject to setoff. Finally, certain of the PG&E Claims assert unliquidated claims
against the Enron Parties, the amount of which is not included.

1 against EPMI that are not being released (items (20), (24) and (27)). All other PG&E
2 Claims against Enron and the Enron Parties (other than EES and EEM), primarily
3 unliquidated claims arising out of FERC refund proceedings, acts in Western energy markets
4 resulting in overcharges and erroneous metering data, and claims against Enron based on the
5 guarantee of such Claims (items (1), (5), (6), (10), (16) (20), (23), (24), (25), (26) and (27),
6 are preserved under the Settlement Agreement.

7 Although no Chapter 11 plan in the Enron Bankruptcy Cases has been approved
8 by the Enron Bankruptcy Court, the plan proposed by Enron provides for distributions on
9 account of unsecured claims of approximately 20% of allowed claims.⁷ Thus, the liquidated
10 PG&E Claims against the Enron Parties being released pursuant to the Settlement
11 Agreement, if allowed in their stated face amounts (adjusted for payments received and
12 elimination of duplicate liability for guarantee claims) as unsecured claims, would receive an
13 estimated recovery of approximately \$15 million.

14 **D. The Settlement Agreement**

15 PG&E and the Enron Parties were in negotiations for more than two years in an
16 attempt to resolve the Enron Parties Claims, the PG&E Claims and the parties' respective
17 objections with respect thereto. On December 23, 2003, the Debtor and the Enron Parties
18 (collectively, the "Parties") finalized and executed the Settlement Agreement, subject to the
19 approval of this Court and the Enron Bankruptcy Court, the terms of which are summarized
20 below. A copy of the Settlement Agreement is attached as Exhibit A to the Wan
21 Declaration.⁸

22
23 ⁷The plan proposed by Enron actually provides for different recovery percentages
with respect to each of the Enron debtors, but the percentages for the Enron Parties (other
than ECC which is not in bankruptcy) are in the range of approximately 20%.

24 ⁸PG&E is not attaching copies of the Settlement Agreement to the service copies of
25 the Wan Declaration because it is too voluminous. However, PG&E will make copies of
26 such document available to anyone being served with this Motion and the Wan Declaration.
27 Any person served with this Motion and the Wan Declaration may obtain a copy of the
Settlement Agreement by written request by mail to Howard, Rice, Nemerovski, Canady,
28 Falk & Rabkin, Attn: Nathaniel H. Hunt, Three Embarcadero Center, 7th Floor, San
Francisco, California 94111-4024, or by e-mail request to nhunt@howardrice.com.
Additionally, copies of the Settlement Agreement will be available at the hearing on this
Motion if any other person wishes to review it.

1 In addition to the resolution of the Enron Parties Claims and the PG&E Claims as
2 discussed above, the Settlement Agreement contains the following other material terms:

3 **1. Allowed Retail DA Credits Claim And Release Of PG&E Claims**
4 **Against EES, EEM And Related Guarantee Claims**

5 As discussed above, EES and EEM have filed Claim Numbers 8881 and 8882 in
6 the PG&E Bankruptcy Case (items (4) and (5) listed in part I.B. above) (the "EES and EEM
7 DA Credits Claims") in the aggregate amount of \$404 million on account of DA Credits
8 allegedly owed by PG&E. Such DA Credits are the subject of complaints previously filed
9 by EES and EEM with the CPUC (the "CPUC Complaints"). PG&E has opposed the CPUC
10 Complaints, which currently remain pending before the CPUC. PG&E takes the position
11 that, *inter alia*, the DA Credits Claims are based upon wholesale electricity prices that FERC
12 has determined to be unjust and unreasonable and that the CPUC should adjust the DA
13 Credits to reflect just and reasonable electricity prices as determined by FERC.

14 In addition, PG&E has filed Objections to the EES and EEM DA Credits Claims
15 as part of its Omnibus Objection to Direct Access Credit Claims filed on June 28, 2002 in
16 the PG&E Bankruptcy Court (Docket No. 8339). The PG&E Bankruptcy Court's
17 November 5, 2002 order on that objection (Docket No. 10920) ruled that such claims (as
18 well as certain other claims) "constitute 'disputed' claims whose allowance is subject to
19 further proceedings." *Id.* at 2, ¶¶2-3. PG&E also takes the position that the EES and EEM
20 DA Credits Claims are subject to setoff based on debts owed by EES and EEM to PG&E.

21 The Settlement Agreement provides for the allowance of the EES and EEM DA
22 Credits Claims in the aggregate amount of \$229 million (the "Allowed Retail DA Credits
23 Claim"), subject to certain potential reductions, as discussed below, and for the dismissal of
24 the CPUC Complaints. *Id.* §§2.2(a); 4.6; 5.1(a). The Settlement Agreement also provides
25 for the release of the PG&E Claim Numbers 12562, 12563, 12575, 12577, 12579 and 12939
26 against EES (items (3), (4), (9), (11), (13) and (22) listed in part I.B. above) and Claim
27 Numbers 12547, 12574, 12580, 12581 and 12932 against EEM (items (2), (8), (14), (15) and
28 (17) listed in part I.B. above) (collectively, the "PG&E Claims Against EES and EEM")

1 filed in the Enron Bankruptcy Cases, which currently aggregate approximately \$41 million
2 on their face, as well as the release of PG&E Claims against Enron with respect to the
3 guarantee of such claims (including Claim No. 12936 (item (19) listed in part I.B. above)).
4 Id. §§5.1(c); 5.1(f); 5.1(g).

5 The Settlement Agreement expressly preserves PG&E Claim Numbers 22698,
6 22699 and 22700 against EEM, EES and EPMI, respectively (related to erroneous metering
7 data), although such claims may not be setoff against claims of the Enron Parties; and Claim
8 Number 12547 against EEM, limited to recovery against parties other than Enron and its
9 Affiliates, including PG&E's claims against Federal Insurance Company based on the
10 issuance of certain surety bonds. Id. §§5.3(h); 5.3(j).

11 The Settlement Agreement further provides for the release to EES and EEM of
12 amounts that EES and EEM have deposited in escrow with the CPUC (the "CPUC Escrow
13 Account") in the amount of approximately \$22 million, with respect to disputed transmission
14 and distribution charges, which are included in PG&E Claim Numbers 12562 and 12574
15 against EES and EEM, respectively (items (2) and (8) listed in part I.B. above). Id. §4.1.

16 The Settlement Agreement provides for the potential reduction in the amount of
17 the Allowed Retail DA Credits Claims to the extent that Duplicative DA Credits Claims are
18 asserted against PG&E (presumably by EES's or EEM's former customers), PG&E
19 provides appropriate notice to the Enron Parties of such claims ("Scheduled Duplicative DA
20 Credits Claims"), and such claims are allowed in the PG&E Bankruptcy Case.⁹ Id. §2.2. In
21 such event, the amount of the Allowed Retail DA Credits Claim will be reduced by the
22 allowed amount of the Scheduled Duplicative DA Credits Claims, up to a maximum of
23 \$29.5 million (i.e., the Allowed Retail DA Credits Claim could be reduced from \$229
24 million to \$199.5 million). Id. §2.2(e). To the extent that the allowed amount of Scheduled
25 Duplicative DA Credits Claims exceed \$29.5 million, PG&E is liable for the next \$25

26
27 ⁹The Settlement Agreement also provides that EES and EEM have standing to file
28 and prosecute objections to Duplicative DA Credits Claims in the PG&E Bankruptcy Case,
which objections must be filed within 30 days after the Effective Date of the Settlement
Agreement. Id. §2.2(d).

1 million of such amounts without any corresponding further reduction in the amount of the
2 Allowed Retail DA Credits Claim.¹⁰ Id.

3 **2. Allowed Wholesale Power & Gas Claim And Release Of PG&E Claims**
4 **Against ENA And EPMI And Related Guarantee Claims**

5 As discussed above, ENA and ECC have filed Claim Numbers 8878 and 8880 in
6 the PG&E Bankruptcy Case (items (1) and (3) listed in part I.B. above) (the “ENA and ECC
7 Wholesale Power & Gas Claims”) in the aggregate amount of approximately \$120 million
8 based on certain gas agreements. PG&E has filed Objections to the ENA and ECC
9 Wholesale Power & Gas Claims based on various grounds, including that such claims are
10 miscalculated (by a total of approximately \$11 million), and that such claims are subject to
11 setoff based on debts owed to PG&E by ENA and EPMI, including PG&E Claim Numbers
12 12573 and 12578 against EPMI and ENA, respectively (items (7) and (12) listed in part I.B.
13 above), which currently aggregate approximately \$32 million on their face. ENA and ECC
14 have opposed PG&E’s Objections to their Wholesale Power & Gas Claims.

15 The Settlement Agreement provides for the allowance of ENA’s Claim No. 8878
16 and ECC’s Claim No. 8880 in the aggregate amount of \$86 million (the “Allowed
17 Wholesale Power & Gas Claim”).¹¹ Id. §§2.1(a); 5.1(d); 5.1(e). The Settlement Agreement
18 also provides for the release of PG&E Claim Numbers 12573 and 12578 against EPMI and
19 ENA, respectively, and the release of PG&E Claims against Enron with respect to the
20 guarantee of such claims (including Claim No. 12935 against Enron (item (18) listed in part
21 I.B. above), but preserves the other PG&E Claims against ENA, ECC and EPMI, and the

22
23 ¹⁰However, as discussed below, in the event that the allowed amount of Scheduled
24 Duplicative DA Credits Claims exceeds \$54.5 million, then PG&E has the option (but not
25 the obligation) of terminating the provisions of the Settlement Agreement dealing with the
26 Allowed Retail DA Credits Claim (as well as certain related provisions), although the Enron
Parties have the option (but not the obligation) to prevent such termination by agreeing to
further reduce the amount of the Allowed Retail DA Credits Claim below \$199.5 million to
the extent that the allowed amount of Scheduled Duplicative DA Credits Claims exceed
\$54.5 million. Settlement Agreement §7.4.

27 ¹¹Pursuant to the Settlement Agreement, the amount of the Allowed Wholesale Power
28 Gas Claim may be reduced by approximately \$1 million, to the extent that a certain
“Duplicative Wholesale Claim” filed by Wheelabrator Martell, Inc. in the amount of
approximately \$1 million is allowed. Id. §2.1(b).

1 related guarantee claims against Enron (including Claim No. 12938 against Enron (item (21)
2 listed in part I.B. above)). Id. §§5.1(f); 5.3(a); 5.3(b); 5.3(l).

3 **3. Limitation On EES And EEM Recovery On CRS Claims**

4 As discussed above, EES and EEM have filed Claim Numbers 13378 and 13379
5 in the PG&E Bankruptcy Case (items (6) and (7) listed in part I.B. above) (the “CRS
6 Claims”) in the aggregate amount of approximately \$511 million on account of Customer
7 CRS Claims filed against EES and EEM in the Enron Bankruptcy Cases on account of
8 surcharges imposed upon former EES and EEM customers by the CPUC. The CRS Claims
9 assert that to the extent that EES and EEM are liable on the Customer CRS Claims, EES and
10 EEM are entitled to recover such amounts from PG&E.

11 PG&E has filed Objections to the CRS Claims on grounds that such claims were
12 late-filed, which Objections remain pending. In the event that such Objections are not
13 sustained, PG&E expects to file substantive objections to the CRS Claims based on, inter
14 alia, PG&E’s position that it has no legal liability for any breach of contract claims against
15 EES and EEM by their customers.

16 Pursuant to the Settlement Agreement, the CRS Claims are considered “Disputed
17 Claims,” which will remain subject to PG&E’s pending Objections, and, if necessary,
18 additional objections. However, regardless of the outcome of such objections, EES’s and
19 EEM’s maximum aggregate recovery on the allowed CRS Claims will be the lesser of (i)
20 \$30 million and (ii) the product of (A) that portion of the Customer CRS Claims allowed by
21 the Enron Bankruptcy Court and (B) the percentage distribution which claims of the same
22 class as the Customer CRS Claims receive (excluding the Customer CRS Claims from such
23 calculation) in the EES and EEM Bankruptcy Cases (with such percentage distribution
24 calculated as a weighted average based on a formula set forth in the Settlement
25 Agreement).¹² Id. §3.1(a).

26
27 ¹²For example, assuming hypothetically that \$100 million of Customer CRS Claims
28 were allowed by the Enron Bankruptcy Court and that claims of the same class would be
entitled to a 20% distribution in EES’s and EEM’s Bankruptcy Cases, EES’s and EEM’s
maximum recovery on the CRS Claims would be \$20 million (i.e., \$100 million x 20%),

1 **E. Mutual Releases**

2 In addition to the releases of PG&E Claims and Enron Parties Claims discussed
3 above, the Settlement Agreement also contains releases by the Parties' affiliates with respect
4 to the expressly resolved claims, and broad but limited mutual releases between the Parties,
5 excluding certain "Reserved Matters." *Id.* §§5.1; 5.2. The Reserved Matters include, in
6 addition to the matters discussed above which are expressly preserved under the Settlement
7 Agreement, all claims of PG&E against Enron and its Affiliates (including the Enron Parties,
8 except for EES and EEM), relating to issues raised in FERC proceedings regarding alleged
9 violations of the Federal Power Act or Natural Gas Act, dysfunctions or potential
10 manipulation of the Western gas or electric markets by Enron, its Affiliates and others, and
11 all claims of PG&E arising from transactions in the markets operated or administered by the
12 PX and/or the CAISO. *Id.* §5.3. However, (other than the potential adjustments discussed in
13 parts I.D.1, I.D.2 and I.F. above) PG&E waives any right of setoff or recoupment it might
14 otherwise have against the Allowed Retail DA Credits Claim or the Allowed Wholesale
15 Power & Gas Claim based on the Reserved Matters.

16 **F. Retail Settlement Termination Option And Escrow Agreement Provisions**

17 Pursuant to the Settlement Agreement, in the event that the allowed amount of
18 Scheduled Duplicative DA Credits Claims exceeds \$54.5 million, then PG&E has the option
19 (but not the obligation) of terminating certain provisions of the Settlement Agreement (the
20 "Retail Settlement Provisions") by providing written notice to the Enron Parties within 30
21 days after all Scheduled Duplicative DA Credits Claims have been allowed or disallowed by
22 Final Orders of the PG&E Bankruptcy Court (the "Retail Settlement Termination
23 Provision"). *Id.* §7.4. The Retail Settlement Provisions include provisions regarding the
24 Allowed Retail DA Credits Claim, dismissal of the CPUC Complaints, release of the funds
25 in the CPUC Escrow Account, the release of the PG&E Claims Against EES and EEM and
26 the related guarantee claims against Enron, the limitations on recovery of the CRS Claims

27 _____
28 subject to the weighted averaging pursuant to the formula set forth in the Settlement Agreement.

1 and related release provisions in the Settlement Agreement. (Such provisions are discussed
2 in parts I.D.1., I.D.3. and I.E. above). Id. §7.4(a) and (b).

3 However, the Enron Parties have the option (but not the obligation) to prevent
4 PG&E from effectuating the Retail Settlement Termination Provision by agreeing to further
5 reduce the amount of the Allowed Retail DA Credits Claim to the extent that the allowed
6 amount of Scheduled Duplicative DA Credits Claims exceed \$54.5 million (the "Reduction
7 Election"), by providing written notice to PG&E of their acceptance of the Reduction
8 Election (or failing to provide written notice to PG&E of their rejection of the Reduction
9 Election) within 30 days after receipt of PG&E's exercise of the Retail Settlement
10 Termination Option. Id.

11 Based on PG&E's potential exercise of the Retail Settlement Termination
12 Provision, the Settlement Agreement provides for the establishment of an escrow with
13 respect to the transactions contemplated by the Retail Settlement Provisions, in the event that
14 the aggregate amount of Scheduled Duplicative DA Credits Claims filed with the PG&E
15 Bankruptcy Court exceeds \$54.5 million as of the Effective Date. Id. §7.4(c). Such escrow
16 would close, and the transactions contemplated by the Retail Settlement Provisions would
17 become effective if the aggregate amount of Scheduled Duplicative DA Credits Claims
18 allowed by Final Order of the PG&E Bankruptcy Court is less than \$54.5 million. Id.

19 In the event that EES and EEM accept the Reduction Election, upon the Effective
20 Date of the PG&E Plan, the Settlement Agreement provides for release to EES and EEM of
21 the amount of the Allowed Retail DA Credits Claim, net of the amount of the Scheduled
22 Duplicative DA Credits Claims (with the remaining portion of the Allowed Retail DA
23 Credits Claim treated as a Disputed Claim and retained in escrow). Id. Thereafter,
24 additional amounts of the Allowed Retail DA Credits Claim would be released to EES and
25 EEM as Scheduled Duplicative DA Credits Claims are allowed and/or disallowed in the
26 PG&E Bankruptcy Case. Id.

27 In the event that PG&E exercises the Retail Settlement Termination Option and
28 EES and EEM do not accept the Reduction Election, then the items in the escrow will be

1 returned to the Parties that delivered them (excluding any funds delivered from the CPUC
2 Escrow Account, which will be retained in escrow pending a ruling on the dispute with
3 respect thereto or a subsequent settlement thereof), the Retail Settlement Provisions will not
4 become effective, and the Parties will retain all of their rights with respect thereto. Id.

5 As a practical matter, the Parties believe that it is quite unlikely that the Retail
6 Settlement Termination Option or Reduction Election (or the related escrow provisions) will
7 ever be applicable. As a threshold matter, the Retail Settlement Termination Option cannot
8 apply unless the allowed amount of Scheduled Duplicative DA Credits Claims exceeds
9 \$54.5 million. In fact, only one Scheduled Duplicative DA Credits Claim has been filed in
10 the PG&E Bankruptcy Case (Claim No. 8833 by Novellus Systems, in the approximate
11 amount of \$4.5 million (Settlement Agreement, Schedule 2.2(b)))¹³, and the Parties believe
12 that it is unlikely that additional Duplicative DA Credits Claims aggregating more than \$50
13 million will be filed before the Effective Date of the Settlement Agreement¹⁴, the deadline
14 for PG&E to supplement the list of Scheduled Duplicative DA Credits Claims (Schedule
15 2.2(b)). Id. §2.2(b).¹⁵

16 In the event that, as of the Effective Date, the aggregate amount of Scheduled
17 Duplicative DA Credits Claims filed with the PG&E Bankruptcy Court is less than \$54.5
18 million, then the Retail Settlement Termination Option lapses, the escrow provisions will be
19 inapplicable and the Reduction Election will become moot. Id. §7.4(a). Furthermore, even
20 if the aggregate amount of Scheduled Duplicative DA Credits Claims filed with the PG&E
21 Bankruptcy Court exceeds \$54.5 million, the Parties believe that it is very unlikely that such
22 Claims would be allowed in an amount greater than \$54.5 million.

23
24 ¹³The Enron Parties have advised PG&E that the Enron Parties expect that Claim No.
25 8833 will be withdrawn.

26 ¹⁴The Effective Date is defined as the first day upon which appropriate orders
27 approving the Settlement Agreement have been entered by both the PG&E Bankruptcy
28 Court and the Enron Bankruptcy Court, which orders are not subject to any applicable stay
of execution. Id. §1.1.

¹⁵The Parties believe that any additional Scheduled Duplicative DA Credits Claims
are barred by the claims bar date established in the PG&E Bankruptcy Case.

1 Accordingly, while the Settlement Agreement contains detailed provisions
2 regarding the Retail Settlement Termination Option, the Reduction Election and the related
3 escrow, the parties believe that such provisions are unlikely to be relevant as a practical
4 matter.

5 **G. Other Provisions Of The Settlement Agreement**

6 The Settlement Agreement provides that interest on the amount of the Allowed
7 Retail DA Credits Claim and the Allowed Wholesale Power & Gas Claim shall accrue and
8 be paid pursuant to the PG&E Plan and relevant orders of the PG&E Bankruptcy Court, at
9 the rate of 4.19% per annum, commencing on the PG&E Petition Date, compounded
10 annually. Id. §2.3. The Settlement Agreement also contains fairly detailed provisions
11 regarding dispute resolution and confidentiality. Id. §§8.4; 8.15.

12 The Settlement Agreement requires that the Parties promptly seek approval of the
13 Settlement Agreement from their respective Bankruptcy Courts (and share drafts of related
14 documents), and provides that the Settlement Agreement will be null and void (except for
15 certain provisions that survive termination of the Settlement Agreement, such as those
16 relating to dispute resolution, confidentiality and governing law) if it not approved by both
17 Bankruptcy Courts within 90 days after the December 23, 2003 Agreement Date (i.e., by
18 March 22, 2004). Id. §§7.1; 7.2.

19 **II.**

20 **ARGUMENT**

21 **A. Standard For Approval Of A Compromise Under Bankruptcy Law.**

22 “The law favors compromise and not litigation for its own sake” Martin v.
23 Kane (In re A & C Properties), 784 F.2d 1377, 1381 (9th Cir. 1986). Bankruptcy courts
24 have great latitude in approving compromise agreements that are “fair and equitable.”
25 Woodson v. Fireman’s Fund Ins. Co. (In re Woodson), 839 F.2d 610, 620 (9th Cir. 1988).
26 In determining whether a compromise is “in the best interest of the bankrupt estate” (A & C
27 Properties, 784 F.2d at 1382), courts consider the following factors:

28 “(a) The probability of success in the litigation; (b) the difficulties, if

1 any, to be encountered in the matter of collection; (c) the complexity
2 of the litigation involved, and the expense, inconvenience and delay
3 necessarily attending it; [and] (d) the paramount interest of the
4 creditors and a proper deference to their reasonable views in the
5 premises.” (Id. at 1381)

6 PG&E respectfully submits that the Settlement Agreement is fair and equitable
7 and in the best interests of the estate, and that the A & C Properties factors weigh in favor of
8 approving the proposed Settlement Agreement, as discussed below.

9 **B. The Probability of Success is Uncertain.**

10 In a case of this type, the outcome is always uncertain, and the probability of
11 success is difficult to weigh. As discussed above, virtually all of the Objections to the Enron
12 Parties Claims remain unresolved, and they are likely to require extensive litigation to obtain
13 final resolution. Further, in the event that certain of the Objections are not sustained, PG&E
14 anticipates raising additional objections to the Enron Parties Claims, particularly the CRS
15 Claims. At this stage, the expected outcome of the Objections and potential additional
16 objections to the Enron Parties Claims cannot be reliably predicted. Similarly, since neither
17 Enron nor the Enron Parties have yet filed any objections to the PG&E Claims, although
18 such objections are anticipated, there is no way to accurately predict the outcome of such
19 objections.

20 **C. Since The Settlement Agreement Primarily Involves Resolution Of The
21 Enron Parties Claims, The Difficulty Of Collection Factor Is Less Relevant;
22 In Any Event, The Settlement Agreement Reduces The Risk Of PG&E Not
23 Recovering On The PG&E Claims By Effectively Providing For Recovery
24 Through Reduction In The Amount Of The Enron Parties Claims**

25 In view of the fact that the Settlement Agreement primarily involves resolution of
26 the Enron Parties Claims, the second A & C Properties factor (the difficulty with respect to
27 collecting a settlement) is less relevant here than it would be if the settlement primarily dealt
28 with resolution of the PG&E Claims. However, to the extent that the Settlement Agreement
resolves PG&E Claims, it reduces the risk of PG&E’s not recovering with respect to such
claims by effectively providing for recovery on most of the liquidated PG&E Claims
through reduction in the amount of the allowed Enron Parties Claims. In the absence of the

1 Settlement Agreement, PG&E would face difficulties in recovering on such PG&E Claims,
2 based on potential objections to such claims by Enron and the Enron Parties, and uncertainty
3 regarding the treatment of such claims in the Enron Bankruptcy Cases (i.e., through a
4 confirmed Chapter 11 plan or otherwise).

5 In particular, pursuant to the Settlement Agreement, (i) the EES and EEM DA
6 Credits Claims and the ENA and ECC Wholesale Power & Gas Claims (which collectively
7 aggregate approximately \$524 million) are collectively allowed in the maximum aggregate
8 amount \$315 million, which amount can decrease to approximately \$284 million¹⁶ (or even
9 less¹⁷), based on adjustments resulting from the allowed amounts of the Scheduled
10 Duplicative DA Credits Claims and the Duplicative Wholesale Claim, while (ii) PG&E
11 Claims which currently aggregate approximately \$73 million on their face, will be released.
12 See parts I.D.1., I.D.2. and I.F. above. The reduction of at least \$209 million in the allowed
13 amount of the EES and EEM DA Credits Claims and the ENA and ECC Wholesale Power &
14 Gas Claims, as compared to the asserted amounts of such claims (i.e., from \$524 million to
15 \$315 million), thus implicitly reflects PG&E's recovery with respect to the PG&E Claims
16 being released. In this way, the Settlement Agreement reduces the risk of collection with
17 respect to such PG&E Claims.

18 **D. The Disputed Issues Are Complex And Continued Litigation Would Entail**
19 **Unnecessary Expense, Inconvenience and Delay.**

20 As discussed above, the Settlement Agreement is extremely broad in scope and
21 resolves numerous complex issues between the Parties. If the Settlement Agreement is not

22 ¹⁶As discussed in parts I.D.1. and I.D.2. above, the amount of the Allowed Retail DA
23 Credits Claim will be reduced by up to \$29.5 million to the extent that Scheduled
24 Duplicative DA Credits Claim are allowed, and the amount of the Allowed Wholesale
25 Power & Gas Claims will be reduced by up to approximately \$1 million to the extent that the
26 Duplicative Wholesale Claim is allowed.

27 ¹⁷As discussed in part I.F. above, in the event that the Enron Parties exercise the
28 Reduction Election, the amount of the Allowed Retail DA Credits Claim will be further
reduced to the extent that the allowed amount of Scheduled Duplicative DA Credits Claims
exceed \$54.5 million, but subject to the \$25 million "floor" discussed in part I.D.1. above
(i.e., to the extent that the allowed amount of Scheduled Duplicative DA Credits Claims
exceed \$29.5 million, PG&E is liable for the next \$25 million of such amounts without any
corresponding further reduction in the amount of the Allowed Retail DA Credits Claim).

1 approved, PG&E intends to continue litigating its Objection to the Enron Parties Claims
2 which are resolved by the Settlement Agreement, and, if necessary, additional objections, at
3 substantial expense and inconvenience to both the Parties and the Court. In addition, PG&E
4 anticipates that the Parties will incur considerable expense and inconvenience in litigating
5 the contemplated objections by Enron and the Enron Parties to the PG&E Claims which are
6 resolved by the Settlement Agreement.

7 Such litigation would raise many complex and challenging issues, including
8 regarding the validity and appropriate amount of the EES and EEM DA Credits Claims, the
9 ENA and ECC Wholesale Power & Gas Claims and the CRS Claims, and PG&E's setoff
10 rights with respect thereto, as well as regarding the validity and appropriate amount of the
11 PG&E Claims Against EES and EEM, and certain PG&E Claims against ENA and EPMI.
12 These complex issues would presumably require extensive expert analysis and testimony
13 and result in protracted and costly litigation. Based on the foregoing considerations, PG&E
14 believes that the Settlement Agreement eliminates such unnecessary expense, inconvenience
15 and delay, in addition to being economically advantageous, and is thus favorable to PG&E.

16 **E. The Settlement Agreement Would Benefit The Estate And Its Creditors.**

17 The Settlement Agreement, *inter alia*, provides for the Enron Parties Claims
18 aggregating approximately \$1.035 billion¹⁸ to be allowed in a maximum aggregate amount
19 of \$345 million (*i.e.*, a reduction of at least \$690 million), which amount can decrease to
20 approximately \$284 million (or even less), by fully resolving approximately \$524 million of
21 Enron Parties Claims in a maximum allowed amount of \$315 million, and limiting recovery
22 on another approximately \$511 million of Enron Parties Claims to a maximum of \$30
23 million, while fully resolving most of the PG&E Claims, which currently aggregate
24 approximately \$73 million on their face, without the expense, risk and delay inherent in
25 continued litigation. Avoidance of unnecessary litigation will benefit PG&E's creditors by
26 minimizing costs and delay and allowing PG&E's personnel to focus on more critical

27 _____
28 ¹⁸As discussed in part I.B.2. above, the Settlement Agreement does not resolve the
portions of EPMI's Claim No. 8879 that have not previously been disallowed.

1 functions. The Settlement Agreement also avoids the risk that the Enron Parties Claims will
2 be allowed against PG&E's estate in amounts greater than the settlement amounts, as well as
3 the risk of a lower net recovery for the estate with respect to the PG&E Claims resolved by
4 the Settlement Agreement.

5 In view of the foregoing, the Official Committee of Unsecured Creditors has
6 represented to the Debtor that it is in favor of the approval of the Settlement Agreement.

7 **CONCLUSION**

8 Based on all of the factors discussed above, PG&E respectfully submits that the
9 Settlement Agreement is fair and equitable and in the best interests of the estate.
10 Accordingly, PG&E respectfully requests that this Court grant the Motion and enter an order
11 approving the Settlement Agreement between PG&E and the Enron Parties.

12 DATED: January 16, 2004.

13 Respectfully,

14 HOWARD, RICE, NEMEROVSKI, CANADY,
15 FALK & RABKIN
A Professional Corporation

16 By:  _____
17 GARY M. KAPLAN

18 Attorneys for Debtor and Debtor in Possession
19 PACIFIC GAS AND ELECTRIC COMPANY
20
21
22
23
24
25
26
27