UNITED STATES BANKRUPTCY COURT

NORTHERN DISTRICT OF CALIFORNIA

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In Re:	Case No. 01-30923-DM
PACIFIC GAS AND ELECTRIC COMPANY,	San Francisco, California Monday, November 25, 2002 9:30 a.m.
Debtor.	Chapter 11
	Confirmation Hearing Day 6

TRANSCRIPT OF PROCEEDINGS
BEFORE THE HONORABLE DENNIS MONTALI
UNITED STATES BANKRUPTCY JUDGE

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S = Schenker

EXHIBIT INDEX

Debtor's Exhibits:

[*None*]

SAN FRANCISCO, CALIFORNIA, NOVEMBER 25, 2002, 9:30 A.M.

(Call to Order of the Court.)

THE COURT: I told you when we concluded our discussions on Friday I would do my best to dispose of the motion that Mr. Neal made on Thursday. It kept me busy over the weekend. I am prepared to give you a ruling on the motion.

So the following is my ruling on the oral motion of counsel for Pacific Gas and Electric Company, the debtor following completion of the presentation of the case in chief by the California Public Utilities Commission and the official committee of creditors regarding their second amended plan of reorganization, Exhibit 104, which I will refer to as the plan.

An objection to confirmation of a Chapter 11 plan is a contested matter under Bankruptcy Rule 9014, and that rule incorporates Bankruptcy Rule 7052, which in turn adopts verbatim the FRCP 52.

Thus the Court may use FRCP 52(c) to dispose of the matter if the party with the burden of going forward fails to establish in its case in chief its entitlement to relief.

The rule provides in part that if during a trial without a jury a party has been fully heard on an issue and the Court finds against that party on that issue, the Court may enter judgment as a matter of law.

For the following reasons, I have decided to deny

the motion. I do not intend to issue a written order. If and when it is appropriate to do so, I will set forth in writing and in more detail the rationale of my decision which I will now summarize.

Three discrete arguments have been presented by the debtor in support of its motion. First it contends that as matter of fact, the CPUC and the OCC, the joint plan proponents, have not shown that the plan is financially feasible as required by Bankruptcy Code Section 1129(a)(11).

Counsel for debtor points to conditions that have not been met in the highly confident letter from UBS Warburg and several conditions that must be satisfied before Standard & Poor's issues indicative ratings for the debt and preferred stock to be issued under the plan.

Second, the debtor contends that evidence justifying the so-called settlement of the filed rate litigation is insufficient to satisfy the standards for settlements under Rule 9019 and that there has not been any evaluation of the litigation purportedly being settled and the claims being released.

Finally, the debtor contends that as a matter of law the reorganization agreement, Exhibit 4 to the plan, cannot be entered into by the CPUC because to do so would cause it to violate California law.

If California law is violated, then Bankruptcy Code Section 1129(a)(3) would preclude confirmation. That section also requires a plan to be proposed in good faith. But since there has been no contention on this motion that the plan has not been proposed in good faith and that I should deny confirmation on that alternative ground, I will consider only the violation of law portion of that section of the Bankruptcy Code.

Beginning with the financial feasibility contentions, I am satisfied that the joint plan proponents have carried their burden to establish a prima facie case of financial feasibility, even though there remains several conditions the joint plan proponents must satisfy before the plan can become effective.

As the Court discussed during oral argument on the motion, it is not uncommon to issue an order confirming a plan if it is likely that certain conditions will be satisfied later.

I cannot say on the evidence presented to date that the plan could not become effective in the near future. Because on the -- excuse me -- based on the evidence currently before the Court, it seems that the conditions in the UBS Warburg letter and the Standard & Poor's -- excuse me -- the UBS Warburg and Standard & Poor letters could be satisfied with

more time and after more information was received by the joint plan proponents and their advisors.

This is not inconsistent with what is plainly contemplated in Section 7.6 and Section 8.2(b) of the plan.

So to at present, no evidence forecloses the joint plan proponents from obtaining investment grade ratings for the plan -- securities rating from Moody's.

Finally, separately, as I will note in a moment, some changes do need to be made to the reorganization agreement, but that is not dispositive or just not -- those necessary changes do not require that the motion be granted.

Sometime later in these proceedings, depending upon the outcome of the current phase of the confirmation trial and perhaps later as part of the trial on PG&E's plan, I may need to address with counsel the procedure for following up on all pre-effective date conditions in order to assess the interval between any confirmation decision and any effective date.

I want to stress that my statement that the joint plan proponents have made a prima facie case in no way constitutes a finding of feasibility. As soon as I conclude these remarks, we will begin the phase of the trial in which PG&E and other objectors will contest the evidence presented by the joint plan proponents in their case in chief.

As to the second contention, settlement of the filed

rate case and related releases, it would not be appropriate to grant the motion at this time since a schedule for submission of briefs dealing with the so-called equity issues has been established and that matter has not yet been fully briefed or argued.

Apart from the briefing, the thrust of the debtor's argument is that the best interest test has not been satisfied since the filed rate litigation is disposed of for inadequate consideration.

That is part and parcel of the equity argument. It has not even been raised by any creditors who are objecting to confirmation, at least in the context of the extant motion.

We come therefore to the third issue presented, the question of whether the reorganization agreement is invalid because by entering into it, the CPUC may be abrogating its responsibilities to fix rates in the future, impermissibly ceding to this Court jurisdiction vested in the California state courts under PUC Code Section 1759 and improperly purporting to bind future Commissions.

I conclude that future Commissions would be bound as a matter of California law pursuant to Sections 5.1 through 5.3 of the reorganization agreement and as a matter of federal law even without Section 5.1 of the agreement.

PG&E contends that CPUC's execution of the

reorganization agreement as part of confirmation of the plan is ultra vires because it violates CPUC code. In particular, PG&E contends that the plan violates Section 1708 and 723 because it binds future Commissions to take into account certain factors in setting future rates and locks those future Commissions into the plan and reorganization agreement.

As the United States Supreme Court explained in Larson v. Domestic and Foreign Commerce Corp., however, an ultra vires claim rests on the state officer's or agency's lack of delegated power.

A claim of error in the exercise of that power is therefore not sufficient.

Here CPUC acted within its authority under Public Utilities Code Section 701 which confers on the Commission expansive authority to do all things that are specifically designated in the Public Utilities Code or in addition thereto which are necessary and convenient in the supervision and regulation of every public utility in California.

I would note as was discussed during oral argument, I do not believe 701 is a license to disregard other specific provisions of the Public Utilities Code or California law that would contradict the broad power granted in 701.

The broad authority as recognized by the California Supreme Court in Consumers Lobby Against Monopolies v. Public

Utilities Commission and authorizes the Commission to enter into contracts in order to effectuate the Commission's regulatory mission.

As noted in U.S. Ecology, Inc., v. California, the California Legislature need not expressly give an agency the power to make enforceable promises. Administrative officials may exercise such additional powers as are necessary for the due and efficient administration powers expressly granted by statute.

The CPUC has the power to enter into the reorganization agreement with the OCC and to propose the plan which has that agreement as its centerpiece for implementation and which if confirmed becomes a contract to which the CPUC is a party.

Moreover no section of the California Public Utilities Code forbids the CPUC from entering into such contracts. Instead certain provisions provide that future Commissions may rescind or modify orders or decisions of the present Commission -- 1708 -- or that future Commissions may override current rates or classifications if they determine them to be unjust or unlawful -- Section 728.

Here the reorganization agreement is not a quasi judicial or a quasi legislative decision or order of the CPUC subject to modification or rescission under Section 1708.

Rather any order confirming CPUC's plan shall be an independent order by this Federal Court which after intense scrutiny of and opportunity to be heard on the plan.

Section 1708 is not implicated or compromised.

Moreover the reorganization agreement does not set rates or classifications. Section 728 is likewise inapplicable.

The CPUC plan -- excuse me -- the plan and the reorganization agreement do not violate the Public Utilities Code.

In support of its contention that the CPUC plan and reorganization agreement violates state law, PG&E relies heavily on what this Court and the parties have conveniently called the Diablo Canyon decision.

In Diablo Canyon, the CPUC states, The parties agree that we cannot bind future Commissions. And later it states, And we have specifically held that we cannot bind the actions of a future Commission.

And again thus, since the CPUC exercises legislative powers when it sets rates, it appears that any Commission decision which attempts to fix prices that are automatically incorporated into rates over the next 28 years would not bind the successor, end of quote.

Here the CPUC's reorganization agreement and the

plan do not attempt to fix rates or set rates. It is not imposing a methodology on future rates, although it is establishing a floor of costs which should be recoverable as currently required by law in any event.

The most important distinction between this case and Diablo Canyon, however, pertains to the CPUC's status with respect to the contracts at issue.

In Diablo Canyon, the CPUC was not a contracting party to the settlement at issue. Rather it was acting in its quasi judicial function in approving a settlement between the -- between PG&E and other parties.

Here, however, the CPUC is the contracting party, and it is receiving consideration, namely the cooperation and support of OCC, in an effort to defeat a plan which would severely limit the scope of the CPUC's present authority in exchange for its promises in return.

The Commission drew this distinction in its own decision of Southern California Edison, 215 PUR 4th 559, where it held that Diablo Canyon was not applicable to contracts in which it is a party as opposed to when you're just entering an order approving your contract between other parties.

Furthermore, unlike the Diablo Canyon decision, the CPUC plan does not and reorganization agreement do not predetermine rates.

The CPUC has the power to enter into contracts and to subject itself to federal jurisdiction, including a waiver of sovereign immunity. Thus its voluntary sponsorship of the plan and its voluntary entry in to the reorganization agreement binds it and subjects it to this Court's jurisdiction.

The Ninth Circuit in Keith v. Volte (phonetic) and its prior decision in Washington v. Penwell (phonetic) make clear that Federal Courts may enter consent decrees as long as Government agencies do not violate state law in doing so.

The reorganization agreement is not a two-party consent decree in the classic sense, but it most definitely is consensual on the part of the CPUC. There is no violation of California law, and thus the federal cases that I cited would permit the Court to enter such an order approving that agreement.

Next, the Court is being asked to enforce the reorganization agreement. Nothing more. If I thought otherwise, I would agree that California law was being violated and for the reason just stated, could not approve the reorganization agreement.

But I see this Court's role as more limited than PG&E's counsel predicts. If the CPUC failed to establish rates to cover the securities as called for in Section 2.2(i) of the reorganization agreement, it would be in breach.

If the CPUC departed from its historic practice for recovery of prudently incurred costs, defined as recoverable costs in the agreement, it would be in breach.

If the CPUC failed to facilitate achieving and maintaining investment grade ratings, it would be in breach. Beyond that and other instances requiring enforcement of the agreement in this Court, I envision no intrusion into the domain of the state administrative and judicial procedures dealing with these matters of rates, regulation of utilities, and the like.

Any order confirming the plan should expressly and explicitly state that this Court is not undertaking to supplant the state administrative and judicial procedures that traditionally govern the affairs of the debtor as a public utility.

There are areas of concern about the adequacy of the reorganization agreement that I believe need to be corrected. I see a -- I believe I see a discrepancy between the definition of investment grade rating, triple B minus for Standard & Poor's and B double A 3 for Moody's, compared with that level for senior secured debt in Warburg, but a lower rating for senior unsecured debt.

I also think it is necessary either to incorporate the essential terms of the plan securities into the agreement

by reference or otherwise mention them and to provide specifically for the regulatory asset in the reorganization agreement, including an amortization schedule and the accounting requirements, for without these promises, Section 2.2(i) of the agreement may become unenforceable as a matter of contract law.

I expect counsel for the joint plan proponents to attend to these matters promptly, and I will be happy to discuss these points with them and other parties on the record, of course, in more detail at some appropriate time. This is not the appropriate time.

In any event, I believe the reorganization agreement would be enforceable even without Section 5.1 where the Commission recites that its entering into the agreement is binding on future Commissions. This is so because that section could be construed as nothing more than a recital of the legal consequences of this Court's approving that agreement assuming it ever does.

The reason is simple. An order of this Court confirming the plan and approving the reorganization agreement becomes the law of this case as a federal decree, and the CPUC now and in the future will be bound under principles of res judicata, law of the case, judicial estoppel, and similar doctrines.

Thus PUC Code Section 1708 is not implicated even by that provision.

Moreover even if 1708 were implicated, I am convinced by cases such as Louisiana Pacific, a state case, and TWA, a Ninth Circuit case, and Southern Cal Edison, a CPU decision that I mentioned distinguishes Diablo Canyon, that governmental units who have the power to enter into contracts and the duty to make rates may do either or both in proper circumstances and that lawful contracts will be enforced rather than trampled by subsequent rate changes.

Here the CPUC has the power to contract and it is not setting rates under the reorganization agreement, but is instead agreeing not to change the rules of the game so as to reassure the financial markets and to make the plan feasible.

Any rate making must occur as a separate matter. PUC Code Section 728 and 1708 are alive and well and will not be overruled or ignored by approval of the reorganization agreement.

I'll stress again that by denying this motion I'm making no determination of feasibility. I'm making no determination that the plan is confirmable. I am simply saying, based upon the evidence presented, there is insufficient basis for granting of the Rule 52 motion.

That's my decision. I think it's time to proceed

with the PG&E case in chief in opposition to the second amended plan.

Mr. Neal.

MR. NEAL: Thank you, Your Honor. Mr. Schenker will call our first witness.

MR. SPEAKER: Your Honor, while he's getting set, could I just ask one housekeeping question.

THE COURT: Yes, sir.

MR. SPEAKER: At what portion of this process do the parties address the preference questions? That hasn't been clear to me.

THE COURT: Well, that's set for calendar on Wednesday at the hearing.

MR. SPEAKER: Yeah. So, but we're having things today. So I guess the question is --

THE COURT: We're having what today? We're having our trial today.

MR. SPEAKER: I understand, and I'm asking are -- I'm trying to figure out whether questions that would go to preference are appropriate in this phase or not.

THE COURT: Well, you mean questions to witnesses?

MR. SPEAKER: Yes.

THE COURT: Well, I guess I'm confused. We're going to hear from some experts this morning.