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April 30, 2001

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10 Attorneys for Wadham Energy LP

11 UNITED STATES BANKRUPTCY COURT
12 NORTHERN DISTRICT OF CALIFORNIA
13 SAN FRANCISCO DIVISION

14 In Re:

15 PACIFIC GAS & ELECTRIC COMPANY,
16 a California corporation,

17 Debtor.

18 Federal I.D. No. 94-074260

CASE NO. 01-30923 DM

THE HONORABLE DENNIS MONTALI

CHAPTER 11 CASE

NOTICE OF MOTION AND MOTION
BY WADHAM ENERGY LP FOR
ENTRY OF AN ORDER ON AN
EMERGENCY BASIS (i)(A)
COMPELLING THE DEBTOR TO
ASSUME OR REJECT WADHAM'S
POWER PURCHASE AGREEMENT
ON OR BEFORE JUNE 1, 2001, AND
(B) REQUIRING THE DEBTOR TO
PAY FAIR MARKET VALUE IN
ADVANCE FOR ALL ELECTRICITY
DELIVERED BY WADHAM PENDING
ASSUMPTION OR REJECTION OF
ITS POWER PURCHASE
AGREEMENT; OR, IN THE
ALTERNATIVE, (ii) GRANTING
WADHAM RELIEF FROM THE
AUTOMATIC STAY TO ALLOW
WADHAM TO SUSPEND
PERFORMANCE UNDER ITS POWER
PURCHASE AGREEMENT WITH THE
DEBTOR PENDING ASSUMPTION OR
REJECTION THEREOF

Date: May 10, 2001

Time: 1:30 p.m.

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

1 **PLEASE TAKE NOTICE** that on May 10, 2001, at 1:30 p.m. or as soon thereafter as
2 the matter may be heard in the Courtroom of the Honorable Dennis Montali, located at 235 Pine Street,
3 22nd Floor, San Francisco, California, Wadham Energy LP ("Wadham") will and hereby does move (the
4 "Motion"), pursuant to sections 105(a), 362(d)(1) and 365(d)(2) of Title 11 of the United States Code
5 (11 U.S.C. § 101 et seq.) (the "Bankruptcy Code") and Rules 2002, 4001, 9006 and 9007 of the Federal
6 Rules of Bankruptcy Procedure (the "Bankruptcy Rules") and B.L.R. 4001, for entry of an order on an
7 emergency basis (i) compelling Pacific Gas & Electric Company (the "Debtor") to (a) assume or
8 reject the Power Purchase Agreement between Wadham and the Debtor, dated November 1984,
9 (the "PPA") on or before June 1, 2001, and (b) pay fair market value in advance for all electricity
10 supplied to the Debtor by Wadham pending assumption or rejection of the PPA; or, alternatively
11 (ii) granting Wadham relief from the automatic stay to allow it to suspend performance under the
12 PPA and sell electricity to third parties at market rates until the Debtor assumes or rejects the PPA.

13 This Motion is based on the allegations contained herein, the accompanying
14 Consolidated Memorandum of Points and Authorities, the accompanying Declaration of Alex A.
15 Sugaoka (the "Sugaoka Declaration"), the records and files of this chapter 11 case and any admissible
16 evidence presented to this Court in connection with the hearing on this Motion.

17 **PLEASE TAKE FURTHER NOTICE** that pursuant to the Court's Order Shortening Time, any
18 opposition to the requested relief is to be filed and served on Wadham by May 7, 2001.

19 **OVERVIEW**

20 1. Wadham owns and operates a 26.5 megawatt electric generation plant (the
21 "Facility") in Williams, California. The Facility was conceived, designed, built and financed on the
22 basis of the Debtor's 15-year obligation to purchase electricity from Wadham pursuant to the PPA.
23 Indeed, the viability of Wadham's operations during the last 12 years have at all times been, and
24 currently are, dependent on the revenue from the PPA. Any prolonged failure of the Debtor to pay
25 for electricity, such as occurred prepetition, materially compromises Wadham's ability to continue
26 operating the Facility and producing electricity.

1 2. During the four months prior to the commencement of this chapter 11 case,
2 the Debtor elected not to pay Wadham for electricity and electric capacity as required by the PPA
3 and instead first curtailed, and then stopped making altogether, payments due under the PPA. As
4 of April 6, 2001 (the "Petition Date"), the Debtor had withheld approximately \$7.7 million in
5 payments owed under the PPA, even though Wadham had dutifully performed all of its obligations
6 thereunder, had produced electricity and had delivered that electricity to the Debtor.

7 3. The Debtor's non-payment of this \$7.7 million has brought Wadham to the
8 brink of financial ruin. Given Wadham's current inability to meet its substantial operating expenses,
9 to complete essential maintenance work required to keep the Facility functioning and to satisfy its
10 long-term interest and principal obligations to its lender -- all directly and proximately caused by
11 Debtor's prepetition defaults under the PPA -- Wadham may need to seek protection under chapter
12 11 without prompt relief from this Court as requested herein.

13 4. To ensure not only Wadham's own existence, but also that of the PPA,
14 Wadham either needs (a) the Debtor to honor all of its obligations under the PPA (past and
15 prospective), or (b) to be free to sell its electricity at current market prices (which substantially
16 exceed the contract price provided by the PPA). If there is any delay in the Court providing this
17 ultimate relief, Wadham needs interim permission to sell its electricity at current market prices and
18 terms to the Debtor or to third parties.

19 5. To be clear, Wadham is not requesting that the Court invalidate or otherwise
20 abrogate the PPA; to the contrary, the relief sought herein likely is necessary to preserve the PPA.
21 Under such circumstances, fixing June 1, 2001, as the date by which the Debtor must obtain an
22 order approving an assumption or rejection of the PPA constitutes a "reasonable" period within
23 which to make this decision. In addition, unless the Court requires the Debtor to pay fair market
24 value for electricity in advance of delivery pending its decision on assumption or rejection or allows
25 Wadham temporary relief from the PPA so that it can enter into short-term arrangements for the
26 sale of electricity to solvent buyers willing to pay fair market value, as a practical matter, there may
27 be no effective PPA for the Debtor to assume or reject. Given the magnitude of the Debtor's past
28

1 defaults -- which have had the effect of stripping virtually all of Wadham's cash, current assets and
2 working capital -- the Debtor's April 11 directive that Wadham supply it with electricity and
3 capacity on credit at rates that are significantly below fair market value, without replenishing
4 Wadham's finances, is simply a non-sequitur. In fact, such rates may be insufficient to maintain
5 Wadham's operations. The Debtor must either cure its past defaults (via an assumption of the
6 PPA) or allow Wadham to generate its own cure by selling electricity at fair market value (via a
7 rejection).

8 6. While a debtor's decision to assume or reject an executory contract need not
9 ordinarily be expedited, the current situation is anything but ordinary. The Debtor's conscious
10 decision to hoard cash by accepting four months of deliveries from Wadham without making
11 payment therefor has created an unworkable and potentially disastrous situation for Wadham.
12 Without this Court's immediate intervention as requested herein, Wadham may be unable to
13 replenish its already diminished cash reserves and the Debtor may lose a potentially valuable asset
14 in the form of the PPA.

15 **JURISDICTION AND VENUE**

16 7. This Court has jurisdiction over this Motion and the issues raised hereby
17 pursuant to 28 U.S.C. §§ 157 and 1334. This is a core proceeding pursuant to 28 U.S.C.
18 §§ 157(b)(2)(A), (D), (G), and (M).

19 8. Venue is proper in this Court pursuant to 28 U.S.C. § 1409.

20 **FACTUAL BACKGROUND**

21 9. The relief sought herein is premised on the following allegations, which are
22 supported by and set forth in greater detail in the accompanying Sugaoka Declaration:

23 A. Background

24 10. The Wadham Facility is a small power production facility that is a "qualified
25 facility" under the Public Utilities Regulatory Policies Act of 1978 (16 U.S.C. § 824a-3 et seq.)
26 ("PURPA"); it burns rice hulls to produce electricity and by-products. (Sugaoka Decl., ¶ 3.) The by-
27 products are sold to the steel industry. (Id.) The Facility is capable of generating approximately 26.5

1 megawatts of electricity, which is sufficient to meet the power needs of about 26,500 homes in
2 California. (Id.)

3 B. Wadham's Contractual Relationship With the Debtor.

4 11. Wadham supplies power to the Debtor pursuant to the PPA, which has
5 approximately three years of its original 15-year term remaining. As with most "qualified facilities,"
6 Wadham is dependent upon revenue from a single utility (in this case, the Debtor) which is the sole
7 purchaser of its electricity. (Id. ¶ 6.) About 95% of Wadham's revenue comes from electricity sales to
8 the Debtor, while the remaining 5% comes from Wadham's sale of by-products to the steel industry.
9 (Id.) Such revenues are used to transport rice hulls for use as fuel to run the Facility and pay the other
10 costs associated with the operating and financing of the Facility.

11 12. In 1984, Wadham entered into the PPA with the Debtor (Id., ¶ 7.) In
12 compliance with the avoided cost requirements under PURPA, the PPA provides for energy payments
13 based on the Debtor's avoided cost at the time of delivery. (Id.) Although PURPA pricing based on
14 avoided cost has remained the controlling principle, the method of calculating the avoided cost of energy
15 has changed over the years. (Id., ¶¶ 8 & 9.) From December 1996 until March 2001, the California
16 Public Utility Commission (the "CPUC") set avoided cost from time to time based on a formula that
17 reflected the monthly adjustment of natural gas prices at the California border. (Id.) Under this formula,
18 the avoided cost for the Debtor's purchases was based on a simple average of the border prices at Malin,
19 Oregon (the northernmost entry point for gas into California) and Topock, Arizona (one of the southerly
20 entry points). (Id.)

21 13. The CPUC's March 27, 2001 decision materially modified the historic formula
22 for setting the avoided cost of energy and reset the Debtor's payment obligations under the PPA at a
23 level that is significantly reduced and less than the market price for energy. (Id., ¶ 9.)

24 C. The Debtor's Breach of the PPA and the Effect on Wadham

25 14. Without explanation or justification, the Debtor paid only 15% of the amount
26 due under the PPA for December 2000 and January 2001, and made no payments for February 2001 or
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1 March 2001. (Id., ¶ 11.) The current outstanding payment obligation owed by the Debtor to Wadham
2 for the four-month prepetition period exceeds \$7.7 million. (Id.)

3 15. The Debtor's breaches of the PPA have devastated Wadham's business. As a
4 consequence, Wadham is now exposed to the risk of foreclosure and may soon require the
5 protection of chapter 11 to preserve its assets and business. (Id., ¶¶ 12-15.)

6 16. Wadham's cash is now substantially exhausted. (Id., ¶ 16.) The current
7 balance in Wadham's unrestricted accounts is about \$100,000. (Id.) Wadham lacks adequate cash
8 to satisfy its obligations in the absence of assumption of the PPA by the Debtor or the ability to sell
9 energy and capacity to third parties. (Id.)

10 **THE DEBTOR SHOULD BE COMPELLED**
11 **TO ASSUME OR REJECT THE PPA BY JUNE 1, 2001**

12 17. As set forth further in the accompanying Consolidated Memorandum,
13 section 365(d)(2) of the Bankruptcy Code provides that "the trustee may assume or reject an
14 executory contract . . . at any time before confirmation of a plan, but the court, on the request of
15 any party to such contract . . . may order the trustee to determine within a reasonable period of
16 time whether to assume or reject such contract . . ." 11 U.S.C. § 365(d)(2).

17 18. What constitutes a "reasonable time" is left to the bankruptcy court's
18 discretion in light of the circumstances of the case, including:

19 The nature of the interests at stake, the balance of the hurt to the
20 litigants, the good to be achieved, the safeguards afforded those
21 litigants, and whether the action to be taken is so in derogation of
Congress' scheme that the court may be said to be arbitrary.

22 19. In this case, the Debtor's prepetition default is not simply substantial; it is
23 devastating for Wadham. As catalogued in the accompanying Sugaoka Declaration by the General
24 Manager of Wadham's Asset Manager, the Debtor's prepetition defaults have stripped Wadham of
25 virtually all of its cash and have created a precarious situation whereby the amounts that the Debtor
26 now seeks to pay Wadham for power are insufficient to service, much less satisfy, the debt created
27 by the Debtor's prepetition breaches. (Sugaoka Decl., ¶ 19.)

20. Wadham has no resources with which to make payments to its lender. Moreover, it may not be able to maintain operations in the foreseeable future absent this Court's intervention (or the intervention of another bankruptcy court which may soon be presiding over Wadham's chapter 11 case if the relief requested herein is denied). (*Id.*, ¶ 15.)

21. Wadham has only two primary sources of revenue -- the PPA and sales to the steel industry of ash by-products generated by the Facility. (Id., ¶ 6.) On the other side of the ledger, Wadham has obligations to its employees, its rice hull suppliers, and its lender in addition to normal operational expenses. (Id., ¶¶ 5, 6.)

22. After the Debtor arbitrarily turned off Wadham's cash flow, Wadham still continued operations, incurring huge obligations. Without revenue from the Debtor, Wadham's cash position became increasingly precarious.

23. Based on current cash usage rates, Wadham will have current payables exceeding available cash as of April 30, 2001. (*Id.*, ¶ 16.)

24. As a direct result of the Debtor's failure to pay Wadham for delivered electricity over the four month period preceding the commencement of this chapter 11 case and the Debtor's failure to take any meaningful remedial action since, Wadham now languishes in a new form of "debtor's prison:" the Debtor is unwilling to provide Wadham with the relief it needs to meet its obligations, and the PPA prevents Wadham from accessing the market to otherwise meet its obligations.

25. Absent relief, Wadham's only remedy may be to commence its own chapter 11 case and to seek relief therein regarding the PPA in order to freely sell its electricity at a fair market price.

26. Under such circumstances, Wadham is entitled to an order from this Court directing the Debtor to promptly assume or reject the PPA.

1 **THE DEBTOR SHOULD BE COMPELLED**
2 **TO PAY IN ADVANCE THE FAIR MARKET**
3 **VALUE OF ELECTRICITY PENDING ITS**
 ASSUMPTION OR REJECTION OF THE PPA

4 27. On April 11, 2001, the Debtor sent Wadham a unilateral directive purporting
5 to require that Wadham deliver energy and contract capacity (i) at the rates established in the PPA
6 or even at a lower rate pending certain unspecified contingencies and (ii) on credit terms allowing
7 for at least fifteen days of credit every month. (Sugaoka Dec. at Ex. E.)

8 28. Wadham may not have the wherewithal to perform on these terms in light of
9 the extent of the Debtor's prepetition defaults. Moreover, the Bankruptcy Code does not entitle
10 the Debtor to performance on the terms which it seeks.

11 29. First, no party, including Wadham, can be forced to extend credit to the
12 Debtor, at least without the Debtor's assumption of the agreement that contemplates the provision
13 of credit. If the Debtor wishes to obtain credit from a third party, its rights and those of its
14 proposed lender are controlled by section 364 of the Bankruptcy Code. No provision is found
15 therein (or anywhere else in the Bankruptcy Code) that could in any way be construed to give the
16 Debtor the power to compel a proposed lender to extend credit against its will.

17 30. Yet, that is precisely the result that will pertain here if Wadham is able to
18 maintain operations and the Debtor is not required to pay for electricity in advance. Wadham's
19 Facility is directly connected to the Debtor's power grid. When the Facility generates electricity, it
20 is immediately delivered to the Debtor, which, in turn, pays for it later under the PPA.

21 31. Thus, absent an enforceable agreement regarding credit terms, and absent
22 the protections of section 364 of the Bankruptcy Code, the mere fact of Wadham's postpetition
23 operation results in an involuntary extension of credit to the Debtor -- unless the Debtor is ordered
24 to pay Wadham in advance.

25 32. If Wadham were to continue to supply electricity to the Debtor at current
26 market prices, the Debtor would be incurring additional indebtedness to Wadham at the rate of
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1 \$160,000 per day. In the first fifteen days of each month (the credit terms sought in the Debtor's
2 April 11 directive), Wadham's exposure would thus be approximately \$2.4 million.

3 33. Wadham has already been damaged enough by the Debtor's failure to meet
4 its payments and thus cannot be forced to extend further credit to the Debtor at this time.
5 Accordingly, deliveries should be pre-paid by the Debtor.

6 34. Second, as set forth in the accompanying Consolidated Memorandum,
7 pending the Debtor's decision to assume or reject the PPA, the Debtor is obligated to pay for the
8 reasonable value of Wadham's postpetition deliveries. Absent the Debtor's assumption of the PPA,
9 it is clear that the reasonable value of the electricity provided by Wadham to the Debtor is not the
10 price contemplated by the PPA, which reflects a long-term commitment to purchase electricity. In
11 fact, the PPA price is significantly less than the fair market value of electricity delivered on a short-
12 term basis, and may not cover Wadham's cost of operation and does not cover Wadham's debt
13 requirements. (Sugaoka Decl., ¶ 9.)

14 35. The Bankruptcy Code does not permit the Debtor to withhold the \$7.7
15 million it owes Wadham, refuse to make a prompt decision to assume or reject the PPA, and then
16 add insult to injury by compelling delivery of Wadham's power at prices far below market value.

17 36. Therefore, if the Debtor elects to receive electricity from Wadham pending
18 its decision to assume or reject, it should pay in advance the fair market value for such electricity.

19 **ALTERNATIVELY, THE AUTOMATIC STAY SHOULD BE LIFTED**
20 **TO PERMIT WADHAM'S SUSPENSION OF PERFORMANCE UNDER THE**
PPA PENDING THE DEBTOR'S DECISION TO ASSUME OR REJECT THE PPA

21 37. As an alternative to the relief requested above, the Court should grant relief
22 from the automatic stay to permit Wadham to suspend its performance under the PPA pending the
23 Debtor's assumption or rejection thereof, and permit Wadham to sell electricity to creditworthy
24 third parties.

25 38. Such relief from the automatic stay is warranted under section 362(d)(1)
26 which provides that "on request of a party in interest . . . the court shall grant relief from the stay
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1 provided under subsection (a) of this section . . . for cause, including the lack of adequate
2 protection of an interest in property of such party in interest.” 11 U.S.C. § 362(d)(1).

3 39. Here, “cause” clearly exists for relief from the stay. If Wadham is not
4 permitted to sell at market price, Wadham may be irreversibly harmed. Because of the Debtor’s
5 material payment breaches under the PPA, Wadham has depleted its working capital to the point
6 where it lacks the resources to make payments to its lender. (Sugaoka Decl., ¶ 16.)

7 40. The Debtor’s April 11 demand to pay the rates under the PPA, which may
8 have been sufficient to keep Wadham in business under other circumstances, is entirely insufficient
9 now that Wadham’s resources have been depleted by the Debtor’s past defaults. As things
10 currently stand, the Debtor’s proposal for postpetition payments pending assumption or rejection
11 will only aggravate Wadham’s dire financial situation and could result in the bankruptcy of
12 Wadham. Consequently, the Debtor could lose the PPA (which would likely be rejected in
13 Wadham’s bankruptcy).

14 41. By comparison, all constituencies will actually be benefited by Wadham’s
15 suspension. Wadham will be able to continue operations, produce electricity and mitigate its
16 damages. The Debtor will have the ability to purchase electricity from Wadham either by assuming
17 the PPA (which will be preserved by Wadham’s ongoing viability) and curing its defaults or by
18 paying market price for postpetition electricity delivered by Wadham.

19 CONCLUSION

20 42. For all the foregoing reasons, Wadham requests that this Court enter an
21 order (i) granting Wadham’s motion to compel the Debtor promptly to assume or reject the PPA
22 and directing the Debtor to pay to Wadham market price in advance for electricity delivered to it in
23 the interim; or (ii) granting Wadham relief from the automatic stay to allow it to suspend
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1 performance under the PPA until such time that the Debtor elects to assume or reject the PPA; and
2 (iii) granting such other and further relief as the Court deems just.

3 Dated this 30 day of April, 2001.

4 Respectfully Submitted,

5 WHITE & CASE, LLP

6
7 By Brian L. Holman
8 Brian L. Holman
9 Attorneys for Wadham Energy LP

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2 Jerry R. Bloom (State Bar No. 138873)
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10 Attorneys for Wadham Energy LP

11 UNITED STATES BANKRUPTCY COURT
12 NORTHERN DISTRICT OF CALIFORNIA
13 SAN FRANCISCO DIVISION

14 In Re:
15 PACIFIC GAS & ELECTRIC COMPANY,
16 a California corporation,
17 Debtor.
18 Federal I.D. No. 94-074260

19 CASE NO. 01-30923 DM
20 THE HONORABLE DENNIS MONTALI
21 CHAPTER 11 CASE
22 DECLARATION OF ALEX A.
23 SUGAOKA IN SUPPORT OF WADHAM
24 ENERGY LP'S EMERGENCY MOTION
25 FOR AN ORDER (i) (A) COMPELLING
26 THE DEBTOR TO ASSUME OR
27 REJECT WADHAM'S POWER
28 PURCHASE AGREEMENT WITH THE
DEBTOR ON OR BEFORE JUNE 1,
2001, AND (B) REQUIRING THE
DEBTOR TO PAY FAIR MARKET
VALUE IN ADVANCE FOR ALL
ELECTRICITY DELIVERED BY
WADHAM PENDING ASSUMPTION
OR REJECTION OF ITS POWER
PURCHASE AGREEMENT; OR, IN
THE ALTERNATIVE, (ii) GRANTING
WADHAM RELIEF FROM THE
AUTOMATIC STAY TO ALLOW IT
TO SUSPEND PERFORMANCE
UNDER ITS POWER PURCHASE
AGREEMENT WITH THE DEBTOR
PENDING ASSUMPTION OR
REJECTION THEREOF

Date: May 10, 2001
Time: 1:30 p.m.
Place: 235 Pine Street, 22nd Floor,
San Francisco, California

1
2 I, Alex A. Sugaoka, declare and say:

3 1. I am the General Manager of the Asset Manager (UAE Energy Operations
4 Corp.) for Wadham Energy LP ("Wadham"). I make this declaration in support of Wadham's
5 emergency motion for entry of an order (i)(A) compelling the Debtor to assume or reject the Power
6 Purchase Agreement between Wadham and the Debtor, dated November 1984, (the "PPA") on or
7 before June 1, 2001, and (B) compelling the Debtor to pay fair market value in advance for
8 electricity delivered to it by Wadham pending assumption or rejection of the PPA; or (ii) granting
9 Wadham relief from the automatic stay to allow Wadham to suspend performance under the PPA
10 pending assumption or rejection. I have personal knowledge as to the matters described in this
11 declaration, and I am competent to testify on these matters.

12 2. Wadham is structured as a single purpose company. It owns a plant in
13 Williams, California which burns rice hulls to produce electricity (the "Facility"). The nature of its
14 business operations is such that its operating revenues are limited to sales of energy and capacity to
15 Pacific Gas and Electric Company (the "Debtor") and sales of by-products to the steel industry. As
16 described in greater detail below, Wadham is presently operating in a precarious cash shortfall
17 situation as a direct result of the Debtor's refusal to pay in full for four months of electricity which
18 Wadham delivered and the Debtor accepted and used. Unless immediate action is taken by this
19 Court, Wadham's increasing financial distress may compel Wadham to file its own bankruptcy
20 petition.

21 Background

22 3. Wadham is a small power production renewable energy facility, producing
23 electric energy from a waste product from the rice industry (the excess hulls from the rice millers).
24 Wadham is a "qualifying facility" or "QF" as defined by the Public Utilities Regulatory Policies Act of
25 1978 ("PURPA"), as amended, 16 U.S.C. 824a-3, et seq., and the regulations enacted thereunder, which
26 entitles it to receive certain protections and exemptions under PURPA (e.g., exemption from certain
27 state and federal utility regulations).

28 4. As a QF, Wadham is an important source of clean, reliable electricity, recycling

1 waste products that otherwise would potentially be disposed of in landfills. Under PURPA, my
2 understanding is that a QF such as Wadham is entitled to receive the electric utility's full avoided cost for
3 electricity, which is generally the incremental cost of operation that the utility would have paid to
4 generate the electricity itself or buy from a third party for the last megawatt hour of electricity generated
5 at any given time, but for the QF providing the power. These costs of operation are generally referred to
6 as the Avoided Costs (the "Avoided Costs").

7 5. The major components of Wadham's costs of operation include (1) the costs to
8 transport (i.e. truck) its fuel (i.e. rice hulls) to the Facility, (2) the costs of labor to run the Facility, which
9 consist of at least 32 site personnel and (3) maintenance expenditures to address the day-to-day and
10 overhaul costs for the extensive system needed to store, process, burn and generate electricity from rice
11 hulls. The Facility generates 26.5 megawatts of electrical power, an amount which is sufficient to meet
12 the power needs of about 26,500 homes in California.

13 6. Wadham is dependent upon revenue from the Debtor because it is the only
14 purchaser of Wadham's electricity. Such revenue constitutes approximately 95% of Wadham's total
15 monthly revenue. The remaining revenues are derived from the sales of rice hull ash by-products to the
16 steel industry. Thus, Wadham's operation is funded from, and dependent on, the revenue from the
17 Debtor, such that any major default under the PPA seriously jeopardizes Wadham's ability to
18 continue supplying power and its saleable by-products.

19 The PPA

20 7. In 1984, Wadham entered into a Power Purchase Agreement (the "PPA") with a
21 term expiring in 2004 to sell the electricity generated by its facility to the Debtor pursuant to the form of
22 standard offer contracts that the California Public Utilities Commission (the "CPUC") had adopted in
23 1982. Attached to my declaration as Exhibit A is a true and correct copy of the PPA. In compliance
24 with PURPA, the PPA provides for energy payments based on the Debtor's "Avoided Costs" at the time
25 of delivery. See PPA, Ex. A, Article 4.

26 8. My understanding is that although the PURPA pricing benchmark of Avoided
27 Costs remains the controlling federal standard on parties to the PPA, the method of calculating the
28 avoided cost of energy in California has changed throughout the years. From 1996 until 2001, pricing

1 was based on a formula (the "Transition Formula") which included a component for the price of natural
2 gas (the "Natural Gas Component") which averaged the monthly indices for natural gas prices at Malin,
3 Oregon, the northerly intake for California (the "Malin Gas Price"), and at Topock, Arizona, the primary
4 southerly intake for California (the "Topock Gas Price"). Attached to my declaration as Exhibit B is a
5 true and correct copy of the CPUC's December 1996 Decision setting forth the Transition Formula,
6 Dec. No. 96-12-028. Although Wadham does not use gas to generate its electricity, the Debtor paid
7 Wadham, like other QFs, based on the Transition Formula.

8 9. The March 27, 2001 decision of the CPUC (the "Wood Decision"), which
9 became effective April 1, 2001, eliminated the Transition Formula and instead determined that the
10 Natural Gas Component of the Avoided Cost formula shall be based solely on the Malin Gas Price rather
11 than the average of the Malin Gas Price and Topock Gas Price (The "Wood Decision Formula").
12 Attached to my declaration as Exhibit C is a true and correct copy of the Wood Decision. Due to the
13 increasing disparity between the Topock Gas Price and the Malin Gas Price over the past year, the
14 Debtor is paying less to QFs, including Wadham, as a result of the Wood Decision than it would have
15 paid under the Transition Formula. Currently, the Wood Decision Formula stipulates electric pricing
16 that is significantly less than market prices. In April 2001, "all-in" prices under the PPA were
17 approximately \$100/MWh.

18 10. It is my understanding that several QFs and a trade association known as the
19 California Cogeneration Council ("CCC") have filed a petition with FERC to have the Wood Decision
20 reviewed (the "CCC Petition"). A true and correct copy of the CCC Petition is attached to my
21 declaration as Exhibit D. There is no assurance that there will be any action forthcoming from FERC in
22 the near term.

23 The Debtor's Breach of the PPA and the Resulting Effect on Wadham

24 11. The Debtor's failure to pay for the electricity that Wadham provided to it
25 between December 2000 and March 2001 has created serious liquidity and bankruptcy risks for
26 Wadham. The Debtor paid only 15% of the amounts owing for December 2000 and January 2001, and
27 paid nothing for February or March 2001. As outlined in the table below, through March 31, 2001, the
28 Debtor owes Wadham at least \$7.7 million excluding interest on account of its prepetition defaults, with

no prospect of payment of this claim in sight.

Billing		Payment		
Period	Amount	Period	Amount	Ending Balance
WADHAM ENERGY LP ACCOUNTS RECEIVABLE FROM PG&E				
Dec-00	\$2,961,094			
Jan-01	\$2,422,684			
Feb-01	\$1,990,260	Feb-01	\$444,064 ¹	
Mar-01	\$1,242,000	Mar-01	\$375,416 ²	
Total	\$8,616,038		\$819,480	\$7,796,558

12. Wadham is incurring a cash liquidity squeeze, as a direct result of the Debtor's prepetition breaches, that may induce bankruptcy. The Facility is due for major overhaul work on the turbine (the primary machinery producing electricity) in 2001. This work requires substantial capital in addition to the typical operating, fuel and capital expenses. In the absence of prompt relief from this Court, Wadham may not be able to complete this essential work.

13. Wadham is at risk with respect to its performance on key long-term fuel contracts with terms that are commensurate with its PPA with the Debtor. Wadham is responsible for paying for transportation services to move rice hulls from its contract mills twenty-four hours a day, seven days a week. If Wadham's liquidity problems continue, Wadham may breach its long-term fuel contracts and the contracts may be abrogated, which could effectively eliminate Wadham's ability to operate economically going forward.

14. Wadham is also at risk with respect to payments on interest on its long-term tax-exempt debt. If Wadham's liquidity problems continue, Wadham may default on its obligations and the bonds may be prematurely called.

15. Wadham is also at risk of default on its principal payment obligations with its lender. The lender has rescinded and forbore on principal payment obligations beginning in the fourth

¹ Represents partial payment for December 2000.

² Represents partial payment for January 2001.

1 quarter of 2000. Foreclosure and bankruptcy are material risks unless Wadham performs on the
2 outstanding principal obligations. Payment of Wadham's past and going-forward principal obligations is
3 impossible unless the Debtor pays Wadham the amounts past due or unless Wadham is permitted to sell
4 its electricity at market price.

5 16. As a result of the non-payment of the amounts due from the Debtor, the current
6 balance in Wadham's unrestricted accounts is about \$100,000. Wadham lacks adequate cash to
7 continue to operate economically. Based on current usage rates, Wadham will have current payables
8 exceeding available cash as of April 30, 2001.

9 The Debtor's Postpetition Plans


10 17. It is not at all clear what amounts the Debtor intends to pay to Wadham for its
11 electricity on a go forward basis. Additionally, the Debtor has not provided adequate assurances
12 showing any ability to pay any amounts to Wadham. Even if the Debtor pays under the Wood Formula,
13 it is questionable whether it will be enough to address Wadham's cash liquidity problem. Finally,
14 Wadham does not have any assurance that the Debtor could make up either the historical or go forward
15 amounts that would become due and owing to Wadham if FERC (or some other entity) acts to alter the
16 impact of the Wood Decision.

17 18. On April 11, 2001, the Debtor sent Wadham a unilateral directive purporting to
18 require that Wadham deliver energy and contract capacity to the Debtor (i) at the rates established in the
19 PPA or even at a lower rate, pending certain unspecified contingencies and (ii) on credit terms allowing
20 for at least 15 days of credit each month. A true and correct copy of the April 11 directive is attached
21 hereto as Exhibit E.

22 19. If Wadham were to supply power to the Debtor at market price, the Debtor
23 would be indebted to Wadham at the rate of about \$160,000 per day. In the first fifteen days of each
24 month (the credit sought), Wadham's exposure would be approximately \$2.4 million. The amounts that
25 Debtor seeks to pay Wadham for power are insufficient to service debt going forward, much less satisfy
26 the debt created by Debtor's prepetition breaches. Moreover, the credit terms upon which Debtor seeks
27 to pay Wadham would also create additional exposure for Wadham that would further exacerbate
28 Wadham's liquidity problems.

1 I declare under penalty of perjury under the laws of the United States and the State of
2 California that the foregoing is true and correct.

3
4 Dated this 30 day of April, 2001, at San Ramon, California.

5
6 
7
8 Alex A. Sugaoka

1 Thomas E Lauria (*pro hac vice* pending)
Jerry R. Bloom (State Bar No. 138873)
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6 Attorneys for KES-Kingsburg LP

7
8 UNITED STATES BANKRUPTCY COURT
9 NORTHERN DISTRICT OF CALIFORNIA
10 SAN FRANCISCO DIVISION

11 In Re:	)	CASE NO. 01-30923 DM
12 PACIFIC GAS & ELECTRIC COMPANY,	)	THE HONORABLE DENNIS MONTALI
13 a California corporation,	)	CHAPTER 11 CASE
14 Debtor.)	
15 Federal I.D. No. 94-074260	)	NOTICE OF MOTION AND MOTION
16	)	BY KES-KINGSBURG LP FOR ENTRY
17	)	OF AN ORDER ON AN EMERGENCY
18	)	BASIS (i) (A) COMPELLING THE
19	)	DEBTOR TO ASSUME OR REJECT
20	)	KINGSBURG'S POWER PURCHASE
21	)	AGREEMENT ON OR BEFORE JUNE
22	)	1, 2001, AND (B) REQUIRING THE
23	)	DEBTOR TO PAY FAIR MARKET
24	)	VALUE IN ADVANCE FOR ALL
25	)	ELECTRICITY DELIVERED BY
26	)	KINGSBURG PENDING
27	)	ASSUMPTION OR REJECTION OF
28	)	ITS POWER PURCHASE
	)	AGREEMENT; OR, IN THE
	)	ALTERNATIVE, (ii) GRANTING
	)	KINGSBURG RELIEF FROM THE
	)	AUTOMATIC STAY TO ALLOW IT
	)	TO SUSPEND PERFORMANCE
	)	UNDER THE POWER PURCHASE
	)	AGREEMENT WITH THE DEBTOR
	)	PENDING ASSUMPTION OR
	)	REJECTION THEREOF
	)	Date: May 10, 2001
	)	Time: 1:30 p.m.
	)	Place: 235 Pine Street, 22nd Floor,
	)	San Francisco, California

1 **PLEASE TAKE NOTICE** that on May 10, 2001, at 1:30 p.m. or as soon thereafter as
2 the matter may be heard in the Courtroom of the Honorable Dennis Montali, located at 235 Pine Street,
3 22nd Floor, San Francisco, California, KES-Kingsburg LP ("Kingsburg") will and hereby does move
4 (the "Motion"), pursuant to sections 105(a), 362(d)(1) and 365(d)(2) of Title 11 of the United States
5 Code (11 U.S.C. § 101 et seq.) (the "Bankruptcy Code") and Rules 2002, 4001, 9006 and 9007 of the
6 Federal Rules of Bankruptcy Procedure (the "Bankruptcy Rules") and B.L.R. 4001, for entry of an order
7 on an emergency basis (i) compelling Pacific Gas & Electric Company (the "Debtor") to (a) assume
8 or reject the Power Purchase Agreement between Kingsburg and the Debtor, dated October 1987,
9 (the "PPA") on or before June 1, 2001, and (b) pay fair market value in advance for all electricity
10 supplied to the Debtor by Kingsburg pending assumption or rejection of the PPA; or, alternatively
11 (ii) granting Kingsburg relief from the automatic stay to allow it to suspend performance under the
12 PPA and sell electricity to third parties at market rates until the Debtor assumes or rejects the PPA.

13 This Motion is based on the allegations contained herein, the accompanying
14 Consolidated Memorandum of Points and Authorities, the accompanying Declaration of James Hinrichs
15 (the "Hinrichs Declaration"), the records and files of this chapter 11 case and any admissible evidence
16 presented to this Court in connection with the hearing on this Motion.

17 **PLEASE TAKE FURTHER NOTICE** that pursuant to the Court's Order Shortening Time, any
18 opposition to the requested relief is to be filed and served on Kingsburg by May 7, 2001.

19 **OVERVIEW**

20 1. Kingsburg leases and operates a 34.5 megawatt electric generation plant (the
21 "Facility") in Fresno County, California. The Facility was conceived, designed, built and financed
22 on the basis of the Debtor's 30-year obligation to purchase electricity from Kingsburg pursuant to
23 the PPA. Indeed, the viability of Kingsburg's operations during its 12 years of existence have at all
24 times been, and currently are, dependent on the revenue from the PPA. Any prolonged failure of
25 the Debtor to pay for electricity, such as occurred prepetition, materially compromises Kingsburg's
26 ability to continue operating the Facility and producing electricity.

1 2. During the four months prior to the commencement of this chapter 11 case,
2 the Debtor elected not to pay Kingsburg for electricity and electric capacity as required by the PPA
3 and instead first curtailed, and then stopped making altogether, payments due under the PPA. As
4 of April 6, 2001 (the "Petition Date"), the Debtor had withheld approximately \$10.3 million in
5 payments owed under the PPA, even though Kingsburg had dutifully performed all of its
6 obligations thereunder, had produced the required levels of electricity and had delivered that
7 electricity to the Debtor.

8 3. The Debtor's non-payment of this \$10.3 million has had grave effects on
9 Kingsburg. Most importantly, having been stripped of its cash flow and subject to a new energy
10 pricing formula (the CPUC's March 27, 2001 Wood Decision), Kingsburg would have been
11 subjected to significant losses provided it even had the financial ability to fund the purchase of
12 natural gas, and, on April 1, 2001, was therefore forced to discontinue operations. Given
13 Kingsburg's projected defaults on its arrangements with its lenders, suppliers and other creditors --
14 all directly and proximately caused by Debtor's prepetition defaults under the PPA -- Kingsburg
15 will only be able to operate at absolutely minimum levels for the peak May through September
16 season and not thereafter unless this Court grants prompt relief as requested herein. In the absence
17 of prompt relief, Kingsburg will have little choice but ultimately to seek protection itself under
18 chapter 11.

19 4. In order to avoid bankruptcy and to resume full operations, Kingsburg either
20 needs (a) the Debtor to honor all of its obligations under the PPA (past and prospective), or (b) to
21 be free to sell its electricity at current market prices (which substantially exceed the contract price
22 provided by the PPA). If there is any delay in the Court providing this ultimate relief, Kingsburg
23 needs interim permission to sell its electricity at current market prices and terms to the Debtor or to
24 third parties.

25 5. To be clear, Kingsburg is not requesting that the Court invalidate or
26 otherwise abrogate the PPA; to the contrary, the relief sought herein is necessary to preserve the
27 PPA. Under such circumstances, fixing June 1, 2001, as the date by which the Debtor must obtain
28 an order approving an assumption or rejection of the PPA constitutes a "reasonable" period within

which to make this decision. In addition, unless the Court requires the Debtor to pay fair market value for electricity in advance of delivery pending its decision on assumption or rejection or allows Kingsburg temporary relief from the PPA so that it can enter into short-term arrangements for the sale of electricity to solvent buyers willing to pay fair market value, as a practical matter, there will be no PPA for the Debtor to assume or reject. Given the magnitude of the Debtor's past defaults -- which have had the effect of forcing Kingsburg to discontinue operations -- the Debtor's April 11 directive that Kingsburg supply it with electricity and capacity on credit at rates that are significantly below fair market value, without replenishing Kingsburg's finances, is simply a non-sequitur. In fact, such rates are insufficient to support Kingsburg's operations going forward. The Debtor must either cure its past defaults (via an assumption of the PPA) or allow Kingsburg to generate its own cure by selling electricity at fair market value (via a rejection). If such relief is not to be provided immediately, Kingsburg needs interim access to creditworthy buyers and market-based pricing to reestablish credit with its gas suppliers and to satisfy its own past due obligations.

6. While a debtor's decision to assume or reject an executory contract need not ordinarily be expedited, the current situation is anything but ordinary. The Debtor's conscious decision to hoard cash by accepting four months of deliveries from Kingsburg without making payment therefor has created an unworkable situation for Kingsburg. Without this Court's immediate intervention as requested herein, Kingsburg may be unable to replenish its already diminished cash reserves, the Debtor may lose a potentially valuable asset in the form of the PPA, and the California power grid may be short another 34.5 megawatts of electricity, as it heads into the summer months.

JURISDICTION AND VENUE

7. This Court has jurisdiction over this Motion and the issues raised hereby pursuant to 28 U.S.C. §§ 157 and 1334. This is a core proceeding pursuant to 28 U.S.C. §§ 157(b)(2)(A), (D), (G), and (M).

8. Venue is proper in this Court pursuant to 28 U.S.C. § 1409.

FACTUAL BACKGROUND

9. The relief sought herein is premised on the following allegations, which are supported by and set forth in greater detail in the accompanying Hinrichs Declaration:

A. Background of Cogeneration.

10. "Cogeneration" is a term used in the energy industry to describe a single process which produces two useful forms of energy (i.e., electricity and thermal energy). Recognizing the inherent efficiencies of such processes, Congress enacted the Public Utilities Regulatory Policies Act of 1978 (16 U.S.C. § 824a-3 et seq.) ("PURPA") to incentivize the construction, operation and financing of cogeneration facilities.

11. The Kingsburg Facility is a "qualified facility" under PURPA; it burns natural gas to produce electricity and thermal energy. (Hinrichs Dec., ¶ 3.) The thermal energy is sold to Sun-Maid Growers ("Sun-Maid") pursuant to an Energy Service Agreement. (Id., ¶ 2.) The Facility is capable of generating approximately 34.5 megawatts of electricity, which is sufficient to meet the power needs of about 34,500 homes in California. (Id., ¶ 5.)

B. Kingsburg's Contractual Relationship With the Debtor.

12. Kingsburg supplies power to the Debtor pursuant to the PPA, which has approximately 17 years of its original 30-year term remaining. As with most "qualified facilities," Kingsburg is dependent upon revenue from a single utility (in this case, the Debtor) which is the sole purchaser of its electricity. (Id. ¶ 6.) About 99% of Kingsburg's revenue comes from electricity sales to the Debtor. (Id.) Such revenues are used to purchase natural gas (the single largest cost of production) to run the Facility and to pay the other costs associated with the operation and financing of the Facility.

13. In 1987, Kingsburg's predecessor-in-interest entered into the PPA with the Debtor (Id., ¶ 7.) In compliance with the avoided cost requirements under PURPA, the PPA provides for energy payments based on the Debtor's avoided cost at the time of delivery. (Id.) Although PURPA pricing based on avoided cost has remained the controlling principle, the method of calculating avoided cost has changed over the years. (Id., ¶¶ 8 & 9.) Up until March 2001, the California Public Utility Commission (the "CPUC") set avoided cost from time to time based on a formula that reflected the

1 monthly adjustment of natural gas prices at the California border. (Id.) Under this formula, the avoided
2 cost for the Debtor's purchases was based on a simple average of the border prices at Malin, Oregon
3 (the northernmost entry point for gas into California) and Topock, Arizona (one of the southerly entry
4 points). (Id.)

5 14. Over the past year, the fuel gas price environment and fundamental gas price
6 assumptions upon which Kingsburg had been operating for the previous 12 years began to change
7 dramatically. The natural gas prices Kingsburg relies on to produce electricity (i.e., "Topock Gas Price")
8 soared to historic levels. (Id., ¶ 11.) Under the PPA's avoided cost formula, the energy payments to
9 which Kingsburg was entitled also rose necessarily to reflect these increases in fuel costs. This "linked"
10 pricing relationship was, however, materially changed by the CPUC's March 27, 2001 decision, which
11 modified the historic formula for setting avoided cost and reset the Debtor's payment obligations under
12 the PPA at a significantly reduced level. (Id., ¶ 14.)

13 C. The Debtor's Breach of the PPA and the Effect on Kingsburg

14 15. Without explanation or justification, the Debtor paid only 15% of the amount
15 due under the PPA for December 2000 and January 2001, and made no payments for February or March
16 2001. (Id., ¶ 16.) The current outstanding payment obligation owed by the Debtor to Kingsburg for the
17 four-month prepetition period exceeds \$10.3 million. (Id.)

18 16. The Debtor's breaches of the PPA have devastated Kingsburg's business.
19 Kingsburg presently owes about \$4,400,000 to its gas supplier, Sempra Energy Trading
20 ("Sempra"), for gas provided in the months of December 2000 through March 2001. (Id., ¶ 17.)

21 17. Kingsburg has also defaulted on a \$60,000 community service payment and
22 may soon default on its California property tax obligations and its lease payment to GE Capital. As a
23 consequence, Kingsburg is now exposed to the risk of foreclosure and may soon require the
24 protection of chapter 11 to preserve its assets and business. (Id., ¶ 18.)

25 18. Kingsburg was forced to shut down the Facility on April 1, 2001, when it was
26 unable to become current on outstanding gas invoices or to provide assurances of payment in the
27 near future. (Id., ¶ 19.) Kingsburg's cash is now substantially reduced. (Id.)

28

**THE DEBTOR SHOULD BE COMPELLED
TO ASSUME OR REJECT THE PPA BY JUNE 1, 2001**

19. As set forth further in the accompanying Consolidated Memorandum, section 365(d)(2) of the Bankruptcy Code provides that "the trustee may assume or reject an executory contract . . . at any time before confirmation of a plan, but the court, on the request of any party to such contract . . . may order the trustee to determine within a reasonable period of time whether to assume or reject such contract . . ." 11 U.S.C. § 365(d)(2).

20. What constitutes a "reasonable time" is left to the bankruptcy court's discretion in light of the circumstances of the case, including:

The nature of the interests at stake, the balance of the hurt to the litigants, the good to be achieved, the safeguards afforded those litigants, and whether the action to be taken is so in derogation of Congress' scheme that the court may be said to be arbitrary.

21. In this case, the Debtor's prepetition default is not simply substantial; it is devastating for Kingsburg. As catalogued in the accompanying Hinrichs Declaration, the General Manager of Kingsburg's Managing General Partner, the Debtor's prepetition defaults have severely reduced Kingsburg's working capital and have created a precarious situation whereby the amounts that the Debtor now seeks to pay Kingsburg for power are insufficient to service, much less satisfy, the debt created by the Debtor's prepetition breaches. (Hinrichs Dec., ¶ 23.)

22. Kingsburg has no resources with which to make payments to creditors, and is currently not operating, and will operate only partially this summer provided the Debtor makes timely or prepaid energy and capacity payments. Moreover, Kingsburg may ultimately not be able to sustain operations absent this Court's intervention (or the intervention of another bankruptcy court which may soon be presiding over Kingsburg's chapter 11 case if the relief requested herein is denied). (*Id.*, ¶ 2.)

23. Kingsburg has only two primary sources of revenue -- the PPA and its Energy Service Agreement with Sun-Maid for the thermal energy generated by the Facility. (*Id.*, ¶ 6.) On the other side of the ledger, Kingsburg has obligations to, among other creditors, its

1 natural gas supplier, and its lessor, GE Capital, in addition to normal operational expenses. (Id.,
2 ¶¶ 16-18.)

3 24. After the Debtor arbitrarily turned off Kingsburg's cash flow, Kingsburg still
4 continued to buy and convert natural gas and incur obligations to its other creditors. During this
5 period, without revenue from the Debtor, Kingsburg's unpaid obligations skyrocketed, including a
6 \$4.4 million unpaid obligation to Sempra, which in April 2001 sought adequate assurance of
7 payment prior to delivering gas. For that reason, combined with the economic imbalance created
8 by the Wood Decision, Kingsburg came off-line on April 1, 2001. (Id., ¶¶ 17-19.)

9 25. As a direct result of the Debtor's failure to pay Kingsburg for delivered
10 electricity over the four month period preceding the commencement of this chapter 11 case and the
11 Debtor's failure to take any meaningful remedial action since, Kingsburg now languishes in a new
12 form of "debtor's prison:" the Debtor is unwilling to provide Kingsburg with the relief it needs to
13 operate, and the PPA prevents Kingsburg from accessing the market to otherwise meet its
14 operating requirements.

15 26. Absent relief, Kingsburg faces the prospect of foreclosure by its creditors.
16 To avoid this outcome and to return to full capacity operation, Kingsburg's only remedy may be to
17 commence its own chapter 11 case and to seek relief therein regarding the PPA in order to freely
18 sell its electricity at a fair market price.

19 27. Under such circumstances, Kingsburg is entitled to an order from this Court
20 directing the Debtor to promptly assume or reject the PPA.

**THE DEBTOR SHOULD BE COMPELLED
TO PAY IN ADVANCE THE FAIR MARKET
VALUE OF ELECTRICITY PENDING ITS
ASSUMPTION OR REJECTION OF THE PPA**

28. On April 11, 2001, the Debtor sent Kingsburg a directive purporting to require that Kingsburg deliver energy and contract capacity (i) at the rates established in the PPA or even at a lower rate pending certain unspecified contingencies and (ii) on credit terms allowing for at least fifteen days of credit every month. (Hinrichs Dec. at Ex. G.)

29. Kingsburg does not have the wherewithal to perform on these terms in light of the extent of the Debtor's prepetition defaults. Moreover, the Bankruptcy Code does not entitle the Debtor to performance on the terms which it seeks.

30. First, no party, including Kingsburg, can be forced to extend credit to the Debtor, at least without the Debtor's assumption of the agreement that contemplates the provision of credit. If the Debtor wishes to obtain credit from a third party, its rights and those of its proposed lender are controlled by section 364 of the Bankruptcy Code. No provision is found therein (or anywhere else in the Bankruptcy Code) that could in any way be construed to give the Debtor the power to compel a proposed lender to extend credit against its will.

31. Yet, that is precisely the result that will pertain here if Kingsburg is able to resume operations and the Debtor is not required to pay for electricity in advance. Kingsburg's Facility is directly connected to the Debtor's power grid. When the Facility generates electricity, it is immediately delivered to the Debtor, which, in turn, pays for it later under the PPA.

32. Thus, absent an enforceable agreement regarding credit terms, and absent the protections of section 364 of the Bankruptcy Code, the mere fact of Kingsburg's postpetition operation results in an involuntary extension of credit to the Debtor -- unless the Debtor is ordered to pay Kingsburg in advance.

33. If Kingsburg were to come back online and supply electricity to the Debtor at current Short-Run Avoided Cost ("SRAC") prices, the Debtor would be incurring additional indebtedness to Kingsburg at the rate of \$80,000 per week day. In the first fifteen days of each

1 month (the credit terms sought in the Debtor's April 11 directive), Kingsburg's exposure would
2 thus be approximately \$885,000.

3 34. Kingsburg has already been damaged enough by the Debtor's failure to meet
4 its payments and thus cannot be forced to extend further credit to the Debtor at this time.
5 Accordingly, deliveries should be pre-paid by the Debtor.

6 35. Second, as set forth in the accompanying Consolidated Memorandum,
7 pending the Debtor's decision to assume or reject the PPA, the Debtor is obligated to pay for the
8 reasonable value of Kingsburg's postpetition deliveries. Absent the Debtor's assumption of the
9 PPA, it is clear that the reasonable value of the electricity provided by Kingsburg to the Debtor is
10 not the price contemplated by the PPA, which reflects a long term commitment to purchase
11 electricity. (Hinrichs Dec., ¶ 23.) In fact, the PPA price is significantly less than the fair market
12 value of electricity delivered on a short-term basis, and does not cover Kingsburg's cost of
13 operations. (*Id.*, ¶ 15.)

14 36. The Bankruptcy Code does not permit the Debtor to withhold the \$10.3
15 million it owes Kingsburg, refuse to make a prompt decision to assume or reject the PPA, and then
16 add insult to injury by compelling delivery of Kingsburg's power at prices far below market value.

17 37. Therefore, if the Debtor elects to receive electricity from Kingsburg pending
18 its decision to assume or reject, it should pay in advance the fair market value for such electricity.

19 **ALTERNATIVELY, THE AUTOMATIC STAY SHOULD BE LIFTED**
20 **TO PERMIT KINGSBURG'S SUSPENSION OF PERFORMANCE UNDER THE**
PPA PENDING THE DEBTOR'S DECISION TO ASSUME OR REJECT THE PPA

21 38. As an alternative to the relief requested above, the Court should grant relief
22 from the automatic stay to permit Kingsburg to suspend its performance under the PPA pending the
23 Debtor's assumption or rejection thereof, and permit Kingsburg to sell electricity to creditworthy
24 third parties.

25 39. Such relief from the automatic stay is warranted under section 362(d)(1)
26 which provides that "on request of a party in interest . . . the court shall grant relief from the stay
27 provided under subsection (a) of this section . . . for cause, including the lack of adequate
28 protection of an interest in property of such party in interest." 11 U.S.C. § 362(d)(1).

1 40. Here, "cause" clearly exists for relief from the stay. There is no doubt that,
2 unless Kingsburg is permitted to sell at market price, Kingsburg, the Debtor, and California
3 electricity consumers will all be irreversibly harmed. Because of the Debtor's material payment
4 breaches under the PPA, Kingsburg has depleted its working capital to the point where it lacks the
5 wherewithal to make payments to its creditors and thus to resume full operations. (Hinrichs Dec.,
6 ¶ 23.)

7 41. The Debtor's April 11 directive to pay the rates under the PPA, which may
8 have been sufficient to keep Kingsburg in business under other circumstances, is entirely insufficient
9 now that Kingsburg's resources will soon be depleted by the Debtor's past defaults. As things
10 currently stand, the Debtor's proposal for postpetition payments pending assumption or rejection
11 will only aggravate Kingsburg's dire financial situation and would most likely result in the
12 bankruptcy of Kingsburg. Consequently, the Debtor will lose the PPA (which would likely be
13 rejected in Kingsburg's bankruptcy) and California may be deprived of yet another power producer
14 for the critical summer months and the current power crisis will only worsen.

15 42. By comparison, all constituencies will actually be benefited by Kingsburg's
16 suspension. Kingsburg will be able to resume full operations, produce electricity and mitigate its
17 damages. The Debtor will have the ability to purchase electricity from Kingsburg either by
18 assuming the PPA (which will be preserved by Kingsburg's ongoing viability) and curing its
19 defaults or by paying market price for postpetition electricity delivered by Kingsburg. Importantly,
20 California will have available an additional 34.5 megawatts of standard capacity.

21 CONCLUSION


22 43. For all the foregoing reasons, Kingsburg requests that this Court enter an
23 order (i) granting Kingsburg's motion to compel the Debtor to promptly assume or reject the PPA
24 and directing the Debtor to pay to Kingsburg market price in advance for electricity delivered to it
25 in the interim; or (ii) granting Kingsburg relief from the automatic stay to allow it to suspend
26
27
28

1 performance under the PPA until such time that the Debtor elects to assume or reject the PPA; and
2 (iii) granting such other and further relief as the Court deems just.

3
4 Dated this 30 day of April, 2001.

5
6 Respectfully Submitted,

7
8 WHITE & CASE, LLP

9 By 
10 Brian L. Holman
11 Attorneys for KES-Kingsburg LP
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10 Attorneys for KES-Kingsburg LP

11 UNITED STATES BANKRUPTCY COURT
12 NORTHERN DISTRICT OF CALIFORNIA
13 SAN FRANCISCO DIVISION

14 In Re:
15 PACIFIC GAS & ELECTRIC COMPANY,
16 a California corporation,

17 Debtor.

18 Federal I.D. No. 94-074260

Case No. 01-30923 DM

THE HONORABLE DENNIS MONTALI
CHAPTER 11 CASE

DECLARATION OF JAMES HINRICHS
IN SUPPORT OF KES-KINGSBURG
LP'S EMERGENCY MOTION FOR AN
ORDER (i)(A) COMPELLING THE
DEBTOR TO ASSUME OR REJECT
KINGSBURG'S POWER PURCHASE
AGREEMENT WITH THE DEBTOR
ON OR BEFORE JUNE 1, 2001, AND
(2) REQUIRING THE DEBTOR TO
PAY FAIR MARKET VALUE IN
ADVANCE FOR ALL ELECTRICITY
DELIVERED BY KINGSBURG
PENDING ASSUMPTION OR
REJECTION OF ITS POWER
PURCHASE AGREEMENT; OR, IN
THE ALTERNATIVE, (ii) GRANTING
KINGSBURG RELIEF FROM THE
AUTOMATIC STAY TO ALLOW IT
TO SUSPEND PERFORMANCE
UNDER ITS POWER PURCHASE
AGREEMENT WITH THE DEBTOR
PENDING ASSUMPTION OR
REJECTION THEREOF

Date: May 10, 2001

Time: 1:30 p.m.

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

1
2 I, James Hinrichs, declare and say:

3 1. I am the General Manager for the Managing General Partner (PurEnergy,
4 LLC) of KES-Kingsburg LP ("Kingsburg"). I make this declaration in support of Kingsburg's
5 emergency motion for entry of an order (i)(A) compelling the Debtor to assume or reject the Power
6 Purchase Agreement between Kingsburg's predecessor, Kingsburg Cogen, and the Debtor, dated
7 October 1987, (the "PPA") on or before June 1, 2001, and (B) compelling the Debtor to pay fair
8 market value in advance for electricity delivered to it by Kingsburg pending assumption or rejection
9 of the PPA; or (ii) granting Kingsburg relief from the automatic stay to allow Kingsburg to suspend
10 performance under the PPA pending assumption or rejection. I have personal knowledge as to the
11 matters described in this declaration, and I am competent to testify on these matters.

12 2. Kingsburg leases and operates a plant in Fresno County, California (the
13 "Facility") which burns natural gas to produce electricity and thermal energy. Kingsburg's
14 operating revenues are limited to sales of electricity to Pacific Gas and Electric Company (the
15 "Debtor") and sales of thermal energy to Sun-Maid Growers ("Sun-Maid") pursuant to an Energy
16 Service Agreement. As described in greater detail below, Kingsburg presently is not operating as a
17 direct result of the Debtor's refusal to pay in full for four months of electricity which Kingsburg
18 delivered and the Debtor accepted and used. Unless this situation is remedied immediately,
19 Kingsburg's increasing financial distress will ultimately compel Kingsburg to file its own
20 bankruptcy petition.

21 Background

22 3. Kingsburg is a cogeneration facility which produces both electrical and thermal
23 energy. Kingsburg is a "qualifying facility" or "QF", as defined by the Public Utilities Regulatory
24 Policies Act of 1978 ("PURPA"), as amended, 16 U.S.C. 824a-3, et seq., enacted by Congress during
25 the mid-1970 national energy crisis to encourage the development of cogeneration. As a QF, Kingsburg
26 is entitled to certain protections and exemptions under PURPA (e.g., exemption from certain state and
27 federal utility regulations).

1 4. QF-generated power accounts for approximately one-third or 10,000 megawatts
2 (i.e., the power needs of about 10,000,000 private homes) of California's total electrical capacity and
3 represents an important source of clean, reliable electricity. Under PURPA, a QF, such as Kingsburg, is
4 entitled to receive the utility's full avoided cost for electricity, which is generally understood to be the
5 cost that the utility would have paid to generate the electricity itself or buy from a third party, but for the
6 QF providing the electricity (e.g., the costs of fuel and transportation, operating and maintenance
7 expenses, emission offsets, etc.). These costs are generally referred to as the avoided costs (the
8 "Avoided Costs"). For Kingsburg, a major component of Avoided Costs is the price of natural gas.

9 5. Kingsburg burns natural gas as its sole fuel for production to produce electric
10 and thermal energy. The Facility generates a total of 34.5 megawatts of electrical power, an amount
11 which is sufficient to meet the power needs of about 34,500 homes in California.

12 6. The Debtor is the sole purchaser of Kingsburg's electricity. Indeed, revenue
13 from the Debtor constitutes in excess of 99% of Kingsburg's total monthly revenue. (The remaining
14 revenues are derived from Sun-Maid, which purchases thermal energy from Kingsburg). As such,
15 Kingsburg's entire operations are funded from, and depend on, revenues from the Debtor. Any
16 major default under the PPA therefore seriously jeopardizes Kingsburg's ability to continue
17 supplying electrical and thermal energy.

18 The PPA

19 7. In 1987, Kingsburg's predecessor in interest, Kingsburg Cogen, entered into a
20 thirty year Power Purchase Agreement (the "PPA") to sell the electricity generated by its facility to the
21 Debtor pursuant to a standard offer contract that the California Public Utilities Commission (the
22 "CPUC") adopted in 1982. Attached to my declaration as Exhibit A is a true and correct copy of the
23 PPA. In compliance with PURPA, the PPA provides for capacity payments and energy payments based
24 on the Debtor's Avoided Costs at the time of delivery. See PPA, Ex. A, Article 4.

25 8. Although the PURPA pricing benchmark of Avoided Costs remains the
26 controlling federal standard on parties to the PPA, the method of calculating the Avoided Costs of
27 energy in California has changed throughout the years. Initially, the utilities' (e.g. the Debtor) payments
28 for energy were based upon the forecasted Avoided Costs established for each three-month period and

1 no adjustments were made at the end of the period, even if actual fuel and other price-setting
2 components differed from the forecast. To refine the details of this calculation in keeping with PURPA's
3 mandates, the CPUC replaced this three-month Avoided Costs posting with a monthly posting for the
4 utilities. Later, the CPUC adopted an index for calculating the energy component of the price. This
5 methodology used the cost of the avoided fuel, natural gas for example, at a known supply location plus
6 transportation costs to California and was consistently applied for a number of years.

7 9. In 1996, California adopted electricity deregulation, which resulted in utilities
8 such as the Debtor selling off much of their own gas-fired generation. Consequently, a new method had
9 to be devised to determine Avoided Costs because the Debtor and the state's other utilities would no
10 longer own or operate gas-fired generation facilities. The deregulation legislation (Assembly Bill 1890,
11 codified as Public Utilities Code § 390) included a requirement that the CPUC adopt an interim formula
12 to reflect the monthly adjustment of natural gas prices at the California border. After lengthy
13 negotiations among the QFs, the utilities and the CPUC, the CPUC adopted a transition formula in
14 December 1996 (the "Transition Formula"). Attached to my declaration as Exhibit B is a true and
15 correct copy of the CPUC's Decision setting forth the Transition Formula, Dec. No. 96-12-028. For the
16 Debtor, the Transition Formula included a component for the price of natural gas (the "Natural Gas
17 Component") based on a simple average of the monthly indices for natural gas prices at Malin, Oregon,
18 the northerly intake for California (the "Malin Gas Price"), and at Topock, Arizona, the primary
19 southerly intake for California (the "Topock Gas Price"). The PPA avoided energy cost pricing
20 methodology automatically incorporated this new formula, including the Natural Gas Component which
21 was based upon this average of the Malin Gas Price and the Topock Gas Price.

22 10. The prices of the natural gas that Kingsburg relies on to produce electrical and
23 thermal energy are based upon the Topock Gas Price. Kingsburg's reliance on Topock pricing is typical
24 of QFs located in the Southern California area. Between December of 1996 and December of 2000, the
25 Malin Gas Price and the Topock Gas Price were roughly equivalent. Therefore, the gas prices used to
26 calculate Kingsburg's revenues and expenses also were roughly equivalent. To the extent that the prices
27 varied, the Transition Formula acted to moderate the difference by averaging the Topock and Malin
28 pricing systems and therefore bore some relationship to Kingsburg's actual costs.

11. Beginning in December of 2000, the fuel gas price environment and fundamental gas price assumptions upon which Kingsburg had been operating for the previous 12 years began to change dramatically. First, Topock Gas Prices began to soar to historic levels. By December of 2000, the Topock Gas Prices had quintupled from their January 2000 levels. The Topock Gas Prices during 2001 have so far not retreated to historical price levels, and the forward gas-price strips indicate that these gas price indices are likely to stay robust for the rest of 2001, if not longer.

12. Beginning in December of 2000 there also began to be a disparity between the Topock Gas Price and the Malin Gas Price such that neither the Topock Gas Price nor the Malin Gas Price approximated each other. In March of 2001 for example, the Malin Gas Price was \$8.4667 per MMBtu and the Topock Gas Price was \$12.740 per MMBtu.

13. The CPUC's March 27, 2001 Wood Decision, which became effective April 1, 2001, held that the Natural Gas Component of the Avoided Cost formula shall be based solely on the Malin Gas Price rather than the average of the Malin Gas Price and Topock Gas Price (The "Wood Decision Formula"). Attached to my declaration as Exhibit C is a true and correct copy of the Wood Decision. Due to the increasing disparity between the Topock Gas Price and the Malin Gas Price over the past year, the Debtor is paying less to QFs, including Kingsburg, as a result of the Wood Decision than it would have paid under the Transition Formula. Currently, the Wood Decision formula stipulates electric pricing that is significantly less than market prices.

14. Thus, the Avoided Cost Formula changed by the Wood Decision, which is based solely on the Malin Gas Price, no longer yields anything close to the Debtor's true "Avoided Cost," as mandated by PURPA. Kingsburg could not purchase gas at Topock April 2001 prices and operate under the Wood Decision Formula without incurring substantial economic losses that would be commercially unsustainable, and would eventually lead to bankruptcy of the Kingsburg project. Several QFs and the California Cogeneration Council ("CCC"), of which Kingsburg is a member, have filed a petition with FERC to have the Wood Decision reviewed (the "CCC Petition"). A true and correct copy of the CCC Petition is attached to my declaration as Exhibit D. There is no assurance that there will be any decision forthcoming from FERC in the near term.

1 15. As a result of the rising Topock Gas Price, combined with the Wood Decision
2 which keys energy revenues from the Debtor solely to the Malin Gas Price, and the above described
3 disparity between the Topock Gas Price and the Malin Gas Price, Kingsburg is forced to buy high (i.e.,
4 by purchasing gas at the Topock Gas Price) and sell low with significant resulting losses. This disparity
5 between Avoided Cost posting and associated pricing forced Kingsburg to shut down for the month of
6 April 2001 to avoid financial losses.

7 The Debtor's Breach of the PPA and the Resulting Effect on Kingsburg

8 16. The Debtor's failure to pay for the electricity that Kingsburg provided to it
9 between December of 2000 and the present had devastating effects on Kingsburg. As outlined in the
10 table below, the Debtor paid only 15% of the amounts owing for December 2000 and January 2001 and
11 nothing for February or March 2001. Currently, the Debtor owes Kingsburg \$10,359,900.19 excluding
12 interest, on account of its prepetition defaults with no prospect of payment of this claim in sight.

13 **KES-Kingsburg, L.P. - Amounts Owed By PG&E**

<u>Month Generated</u>	<u>Amount</u>	<u>Paid</u>	<u>Difference</u>	<u>Date Paid</u>
December	\$6,716,298.09	\$1,007,444.71	\$5,708,853.38	02/08/2001
January	\$3,732,550.14	\$578,545.27	\$3,154,004.87	03/08/2001
February	\$1,134,591.86	<u>\$0.00</u>	<u>\$1,134,591.86</u>	
March	<u>\$362,450.08</u>	<u>\$0.00</u>	<u>\$362,450.08</u>	
Total	\$11,945,890.17	\$1,585,989.98	\$10,359,900.19	

21 17. The Debtor's breaches of the PPA have devastated Kingsburg. Kingsburg
22 presently owes about \$4,400,000 to its gas supplier, Sempra Energy Trading ("Sempra") for gas
23 provided in the months of December 2000 through March 2001. Kingsburg is also at risk for
24 substantial third party claims from Sempra and from Sun-Maid. Continued non-operation will only
25 exacerbate its risk with Sempra and Sun-Maid. Further, Kingsburg continues to incur site labor
26 and associated costs for the Facility.

1 18. Kingsburg is in default on a community service payment of \$60,000.
2 Without prompt relief from this Court, Kingsburg ultimately will be in default on its lease payments
3 and property taxes and thus is at risk of foreclosure and bankruptcy.

4 19. Kingsburg was forced to shut down its plant on April 1, 2001 as Kingsburg was
5 unable to become current on outstanding gas invoices or provide assurances of payment in the near
6 future. Assurances could not be provided to Sempra as a direct result of the Debtor's inability to
7 perform on then current defaults or provide assurances of payment going-forward. Cash is now
8 substantially reduced.

9 The Debtor's Postpetition Plans

10 20. It is not at all clear what amounts the Debtor intends to pay to Kingsburg for its
11 electricity going forward. The Debtor has not provided a budget or any other evidence of an ability to
12 pay any amounts to Kingsburg. Publicly, the Debtor's officials have stated that they intend to make
13 payments to QFs for future electricity supplies, but only "to the extent they are included in the
14 Company's rates." As I understand the Debtor's rates, that means the Debtor may pay the QFs even less
15 than the amounts due using the Wood Decision Formula. The Debtor's statements filed with the federal
16 Securities and Exchange Commission, as reported in the news media and on their public conference call
17 conducted Friday, April 6, 2001, indicate the Debtor may not pay the QFs the full Wood Decision
18 Formula for the delivered electricity. Finally, Kingsburg does not have any assurance that the Debtor
19 could make up either the historical or going forward amounts that would become due and owing to the
20 Kingsburg if FERC (or some other entity) reverses the Wood Decision.

21 21. The Debtor has defaulted on payments owed not only to Kingsburg but also to
22 many other cogeneration companies. Before the Debtor's bankruptcy filing, its massive breaches of the
23 QFs' contracts, combined with similar defaults by Southern California Edison ("Edison"), prompted
24 several QFs to bring lawsuits seeking legal remedies to the intolerable situation. In one such case, Salton
25 Sea Power Generation L.P. v. Southern California Edison, ("CalEnergy Case"), QFs obtained a legal
26 ruling that they are entitled to suspend their contracts with Edison and sell power on the open market.
27 Attached to my declaration as Exhibit E is a true and correct copy of the order in the CalEnergy Case.
28 Prior to the Debtor's bankruptcy filing, several other QFs filed similar actions against the Debtor seeking

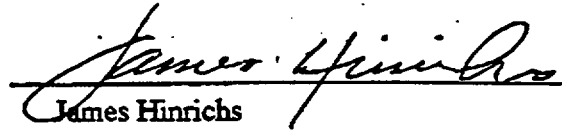
1 suspension of their contracts with the Debtor. Attached as Exhibit F is a petition Ridgewood Power
2 LLC filed with FERC to suspend its PPA and permit sales on the open market though October 2001.

3 22. On April 11, 2001, the Debtor sent Kingsburg a unilateral directive purporting to
4 require that Kingsburg deliver electricity and contract capacity to the Debtor (i) at the rates established in
5 the PPA or even at a lower rate, pending certain unspecified contingencies and (ii) on credit terms
6 allowing for at least 15 days of credit each month. A true and correct copy of the directive is attached
7 hereto as Exhibit G.

8 23. If Kingsburg were to come back online and supply power to the Debtor at the
9 Short-Run Avoided Cost ("SRAC") market rates, the Debtor would be indebted to Kingsburg at the rate
10 of about \$80,000 per weekday (Kingsburg will not operate during off-peak periods because energy
11 revenue from the Debtor will not cover variable costs). In the first 15 days of each month (the credit
12 sought), Kingsburg's exposure would be approximately \$885,000. The amounts that Debtor seeks to
13 pay Kingsburg for power are insufficient to fully service, much less satisfy, the debt created by Debtor's
14 prepetition breaches. Moreover, the credit terms upon which Debtor seeks to pay Kingsburg may also
15 render Kingsburg unable to perform in light of Debtor's prepetition defaults because Kingsburg may be
16 unable to provide the assurances of payment required by its creditors to resume operations.

I declare under penalty of perjury under the laws of the United States and the state of California
that the foregoing is true and correct.

Dated this ____ day of April, 2001, at San Diego, California.


James Hinrichs

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2 Jerry R. Bloom (State Bar No. 138873)
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10 Attorneys for Oildale Energy LLC

11 UNITED STATES BANKRUPTCY COURT
12
13 NORTHERN DISTRICT OF CALIFORNIA
14
15 SAN FRANCISCO DIVISION

16 In Re:
17
18 PACIFIC GAS & ELECTRIC COMPANY,
19 a California corporation,
20
21 Debtor.

22 Federal I.D. No. 94-074260

23 CASE NO. 01-30923 DM
24 THE HONORABLE DENNIS MONTALI
25 CHAPTER 11 CASE
26
27 NOTICE OF MOTION AND MOTION
28 BY OILDALE ENERGY LLC FOR
ENTRY OF AN ORDER ON AN
EMERGENCY BASIS (i)(A)
COMPELLING THE DEBTOR TO
ASSUME OR REJECT OILDALE'S
POWER PURCHASE AGREEMENT
ON OR BEFORE JUNE 1, 2001, AND
(B) REQUIRING THE DEBTOR TO
PAY FAIR MARKET VALUE IN
ADVANCE FOR ALL ELECTRICITY
DELIVERED BY OILDALE PENDING
ASSUMPTION OR REJECTION OF
ITS POWER PURCHASE
AGREEMENT; OR, IN THE
ALTERNATIVE, (ii) GRANTING
OILDALE RELIEF FROM THE
AUTOMATIC STAY TO ALLOW IT
TO SUSPEND PERFORMANCE
UNDER ITS POWER PURCHASE
AGREEMENT WITH THE DEBTOR
PENDING ASSUMPTION OR
REJECTION THEREOF

Date: May 10, 2001
Time: 1:30 p.m.
Place: 235 Pine Street, 22nd Floor,
San Francisco, California

1 **PLEASE TAKE NOTICE** that on May 10, 2001, at 1:30 p.m. or as soon thereafter as
2 the matter may be heard in the Courtroom of the Honorable Dennis Montali, located at 235 Pine Street,
3 22nd Floor, San Francisco, California, Oildale Energy LLC ("Oildale") will and hereby does move (the
4 "Motion"), pursuant to sections 105(a), 362(d)(1) and 365(d)(2) of Title 11 of the United States Code
5 (11 U.S.C. § 101 et seq.) (the "Bankruptcy Code") and Rules 2002, 4001, 9006 and 9007 of the Federal
6 Rules of Bankruptcy Procedure (the "Bankruptcy Rules") and B.L.R. 4001, for entry of an order on an
7 emergency basis (i) compelling Pacific Gas & Electric Company (the "Debtor") to (a) assume or
8 reject the Power Purchase Agreement between Oildale and the Debtor, dated March 1985, (the
9 "PPA") on or before June 1, 2001, and (b) pay fair market value in advance for all electricity
10 supplied to the Debtor by Oildale pending assumption or rejection of the PPA; or, alternatively (ii)
11 granting Oildale relief from the automatic stay to allow it to suspend performance under the PPA
12 and sell electricity to third parties at market rates until the Debtor assumes or rejects the PPA.

13 This Motion is based on the allegations contained herein, the accompanying
14 Consolidated Memorandum of Points and Authorities, the accompanying Declaration of Alex A.
15 Sugaoka (the "Sugaoka Declaration"), the records and files of this chapter 11 case and any admissible
16 evidence presented to this Court in connection with the hearing on this Motion.

17 **PLEASE TAKE FURTHER NOTICE** that pursuant to the Court's Order Shortening Time, any
18 opposition to the requested relief is to be filed and served on Oildale by May 7, 2001.

19 **OVERVIEW**

20 1. Oildale owns and operates a 40 megawatt electric generation plant (the
21 "Facility") in Oildale, California. The Facility was conceived, designed, built and financed on the
22 basis of the Debtor's 30-year obligation to purchase electricity from Oildale pursuant to the PPA.
23 Indeed, the viability of Oildale's operations during its 15 years of existence have at all times been,
24 and currently are, dependent on the revenue from the PPA. Any prolonged failure of the Debtor to
25 pay for electricity, such as occurred prepetition, materially compromises Oildale's ability to
26 continue operating the Facility and producing electricity.

1 2. During the four months prior to the commencement of this chapter 11 case,
2 the Debtor elected not to pay Oildale for energy and capacity as required by the PPA and instead
3 first curtailed, and then stopped making altogether, payments due under the PPA. As of April 6,
4 2001 (the "Petition Date"), the Debtor had withheld approximately \$10.5 million in payments owed
5 under the PPA, even though Oildale had dutifully performed all of its obligations thereunder, had
6 produced the required levels of electricity and had delivered that electricity to the Debtor.

7 3. The Debtor's non-payment of this \$10.5 million has brought Oildale to the
8 brink of financial ruin. Most importantly, having been stripped of its primary source of revenue,
9 Oildale was unable to fund the purchase of natural gas, and, on February 6, 2001, was forced to
10 discontinue operations. Since that date, Oildale has only been able to produce electricity for ten
11 days. Given Oildale's current inability to meet its obligations to its lenders, gas suppliers and other
12 creditors -- all directly and proximately caused by Debtor's prepetition defaults under the PPA --
13 the only hope of reviving Oildale's operations without itself seeking protection under chapter 11 is
14 prompt relief from this Court as requested herein.

15 4. In order to recommence operations, thereby preserving not only Oildale's
16 own existence, but also that of the PPA, Oildale either needs (a) the Debtor to honor all of its
17 obligations under the PPA (past and prospective), or (b) to be free to sell its electricity at current
18 market prices (which substantially exceed the contract price provided by the PPA). If there is any
19 delay in the Court providing this ultimate relief, Oildale needs interim permission to sell its
20 electricity at current market prices and terms to the Debtor or third parties.

21 5. To be clear, Oildale is not requesting that the Court invalidate or otherwise
22 abrogate the PPA; to the contrary, the relief sought herein is necessary to preserve the PPA. Under
23 such circumstances, fixing June 1, 2001, as the date by which the Debtor must obtain an order
24 approving an assumption or rejection of the PPA constitutes a "reasonable" period within which to
25 make this decision. In addition, unless the Court requires the Debtor to pay fair market value for
26 electricity in advance of delivery pending its decision on assumption or rejection or allows Oildale
27 temporary relief from the PPA so that it can enter into short-term arrangements for the sale of
28 electricity to solvent buyers willing to pay fair market value, as a practical matter, there will be no

1 PPA for the Debtor to assume or reject. Given the magnitude of the Debtor's past defaults --
2 which have had the effect of forcing Oildale to discontinue operations -- the Debtor's April 11
3 directive that Oildale supply it with energy and capacity on credit at rates that are significantly
4 below fair market value, without replenishing Oildale's finances, is simply a non-sequitur. In fact,
5 such rates are insufficient to restart Oildale's operations. The Debtor must either cure its past
6 defaults (via an assumption of the PPA) or allow Oildale to generate its own cure by selling
7 electricity at fair market value (via a rejection). If such relief is not to be provided immediately,
8 Oildale needs interim access to creditworthy buyers and market-based pricing to reestablish credit
9 with its gas supplier and to satisfy its own past due obligations.

10 6. While a debtor's decision to assume or reject an executory contract need not
11 ordinarily be expedited, the current situation is anything but ordinary. The Debtor's conscious
12 decision to hoard cash by accepting four months of deliveries from Oildale without making payment
13 therefor has created an unworkable and soon to be disastrous situation for Oildale. Without this
14 Court's immediate intervention as requested herein, Oildale may be unable to replenish its already
15 diminished cash reserves, the Debtor may lose a potentially valuable asset in the form of the PPA,
16 and the California power grid may be short another 40 megawatts of electricity, as it heads into the
17 summer months.

18 JURISDICTION AND VENUE

19 7. This Court has jurisdiction over this Motion and the issues raised hereby
20 pursuant to 28 U.S.C. §§ 157 and 1334. This is a core proceeding pursuant to 28 U.S.C. §§
21 157(b)(2)(A), (D), (G), and (M).

22 8. Venue is proper in this Court pursuant to 28 U.S.C. § 1409.

23 FACTUAL BACKGROUND

24 9. The relief sought herein is premised on the following allegations, which are
25 supported by and set forth in greater detail in the accompanying Sugaoka Declaration:

26 A. Background of Cogeneration.

27 10. "Cogeneration" is a term used in the energy industry to describe a single process
28 which produces two useful forms of energy (i.e., electrical and thermal energy). Recognizing the

1 inherent efficiencies of such processes, Congress enacted the Public Utilities Regulatory Policies Act of
2 1978 (16 U.S.C. § 824a-3 et seq.) ("PURPA") to incentivize the construction, operation and financing
3 of cogeneration facilities.

4 11. The Oildale Facility is a "qualified facility" under PURPA; as a cogeneration
5 facility, it burns natural gas to produce electrical and thermal energy. (Sugaoka Dec., ¶ 3.) The thermal
6 energy is sold to a nearby refinery as its primary source of energy for its refinery operation. (Id. ¶ 5.)
7 The Facility is capable of generating approximately 40 megawatts of electricity, which is sufficient to
8 meet the power needs of about 40,000 homes in California. (Id.)

9 B. Oildale's Contractual Relationship With the Debtor.

10 12. Oildale supplies power to the Debtor pursuant to the PPA, which has
11 approximately one-half of its original 30-year term remaining. As with most "qualified facilities," Oildale
12 is dependent upon revenue from a single utility (in this case, the Debtor) which is the sole purchaser of
13 its electricity. (Id. ¶ 6.) About 85% of Oildale's revenue comes from electricity sales to the Debtor,
14 while the remaining 15% comes from Oildale's thermal energy host. (Id.) Such revenues are used to
15 purchase natural gas (the single largest cost of production) as fuel to run the Facility and to pay the other
16 costs associated with the operation and financing of the Facility.

17 13. In 1985, Oildale entered into the PPA with the Debtor (Id., ¶ 7.) In compliance
18 with the avoided cost requirements under PURPA, the PPA provides for energy payments based on the
19 Debtor's avoided cost at the time of delivery. (Id.) Although PURPA pricing based on avoided cost has
20 remained the controlling principle, the method of calculating the avoided cost of energy has changed
21 over the years. (Id., ¶¶ 8-9.) From December 1996 until March 2001, the California Public Utility
22 Commission (the "CPUC") set the avoided cost of energy from time to time based on a formula that
23 reflected the monthly adjustment of natural gas prices at the California border. (Id.) Under this formula,
24 the Debtor's avoided cost of energy was based on a simple average of the border prices at Malin,
25 Oregon (the northernmost entry point for gas into California) and Topock, Arizona (one of the southerly
26 entry points). (Id.)

27 14. Over the past year, the fuel gas price environment and fundamental gas price
28 assumptions upon which Oildale had been operating for the previous 15 years began to change

1 dramatically. The natural gas prices Oildale relies on to produce electricity (i.e., "Topock Gas Price")
2 soared to historic levels. (Id., ¶ 11.) Under the PPA's avoided cost formula, the energy payments to
3 which Oildale was entitled also rose necessarily to reflect these increases in fuel costs. This "linked"
4 pricing relationship was, however, materially changed by the CPUC's March 27, 2001 decision, which
5 modified the historic formula for setting avoided cost and reset the Debtor's payment obligations under
6 the PPA at a significantly reduced level. (Id., ¶ 13-15.)

7 C. The Debtor's Breach of the PPA and the Effect on Oildale

8 15. Without explanation or justification, the Debtor paid only 15% of the amount
9 due under the PPA for December 2000 and January 2001, and made no payments for February or
10 March. (Id., ¶ 16.) The current outstanding payment obligation owed by PG&E to Oildale for the four-
11 month prepetition period exceeds \$10.5 million. (Id.)

12 16. The Debtor's breaches of the PPA have devastated Oildale's business. Oildale
13 presently owes about \$7,167,000 to its gas supplier, Duke Energy Fuels ("Duke"), for gas provided
14 in the months of December 2000 through February 2001 and has failed to provide Duke with a
15 letter-of-credit of \$5,379,000 as stipulated by Oildale's gas purchase agreement with Duke. Duke
16 has notified Oildale of its defaults and has threatened cancellation. (Id.)

17 17. Oildale has also defaulted on its \$2,500,000 outstanding working capital loan,
18 its senior debt financing and its California property tax obligations. As a consequence, Oildale is
19 now exposed to the risk of foreclosure and may soon require the protection of chapter 11 to
20 preserve its assets and business. (Id., ¶ 18.)

21 18. Oildale was forced to shut down the Facility on February 6, 2001, when it was
22 unable to purchase additional gas required for the Facility's operation. (Id., ¶ 19.) Oildale's cash is
23 now substantially exhausted. (Id.) The current balance in Oildale's unrestricted accounts is about
24 \$250,000. (Id.) Oildale lacks adequate cash or credit to pay for or assure payment for future gas
25 deliveries to restart operations in the absence of assumption of the PPA by the Debtor or the ability
26 to sell electricity and capacity to third parties (Id.) Further, since Oildale shut down operations,
27 Oildale's thermal host laid off 31 of its employees and commenced its own chapter 11 case on April
28 23, purportedly in large part due to its inability to obtain thermal energy from Oildale (Id. ¶ 17.)

**THE DEBTOR SHOULD BE COMPELLED
TO ASSUME OR REJECT THE PPA BY JUNE 1, 2001**

19. As set forth further in the accompanying Consolidated Memorandum, section 365(d)(2) of the Bankruptcy Code provides that "the trustee may assume or reject an executory contract . . . at any time before confirmation of a plan, but the court, on the request of any party to such contract . . . may order the trustee to determine within a reasonable period of time whether to assume or reject such contract . . ." 11 U.S.C. § 365(d)(2).

20. What constitutes a "reasonable time" is left to the bankruptcy court's discretion in light of the circumstances of the case, including:

The nature of the interests at stake, the balance of the hurt to the litigants, the good to be achieved, the safeguards afforded those litigants, and whether the action to be taken is so in derogation of Congress' scheme that the court may be said to be arbitrary.

21. In this case, the Debtor's prepetition default is not simply substantial; it is devastating for Oildale. As catalogued in the accompanying Sugaoka Declaration by the General Manager of Oildale's Asset Manager, the Debtor's prepetition defaults have stripped Oildale of virtually all of its cash and have created a precarious situation whereby the amounts that the Debtor now seeks to pay Oildale for power are insufficient to service, much less satisfy, the debt created by the Debtor's prepetition breaches. (Sugaoka Dec., ¶ 22.)

22. Oildale has no resources with which to make payments to creditors, and is currently not operating. Moreover, it will not be able to operate again in the foreseeable future absent this Court's intervention (or the intervention of another bankruptcy court which most likely will soon be presiding over Oildale's Chapter 11 case if the relief requested herein is denied). (*Id.*, ¶ 2.)

23. Oildale has only two primary sources of revenue -- the PPA and a thermal host contract concerning sales of thermal energy generated by the Facility. (*Id.*, ¶ 6.) On the other side of the ledger, Oildale has obligations to, among other creditors, its natural gas supplier, and its lenders in addition to normal operational expenses. (*Id.*, ¶ 17-18.)

1 24. On February 6, 2001, Duke shut off the gas, forcing Oildale to shut down
2 the Facility. Oildale was unable to become current on outstanding gas invoices or provide
3 assurances of payment in the near future. Assurances could not be provided directly due to the
4 Debtor's inability to perform on then-current defaults or provide assurances of payment going
5 forward. As a result, Oildale's unpaid obligations skyrocketed, including a \$7.1 million unpaid
6 obligation to Duke.

7 25. Based on current cash usage rates, Oildale's remaining unrestricted cash will
8 run out on May 15, 2001. (Id., ¶ 19.)

9 26. As a direct result of the Debtor's failure to pay Oildale for delivered
10 electricity over the four month period preceding the commencement of this chapter 11 case and the
11 Debtor's failure to take any meaningful remedial action since, Oildale now languishes in a new form
12 of "debtor's prison." the Debtor is unwilling to provide Oildale with the relief it needs to operate,
13 and the PPA prevents Oildale from accessing the market to otherwise meet its operating
14 requirements.

15 27. Absent relief, Oildale faces the prospect of a permanent shut-down and
16 foreclosure by its secured lenders. To avoid this outcome and to return to operation, Oildale's only
17 remedy may be to commence its own chapter 11 case and to seek relief therein regarding the PPA
18 in order to freely sell its electricity at a fair market price.

19 28. Under such circumstances, Oildale is entitled to an order from this Court
20 directing the Debtor to promptly assume or reject the PPA.

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**THE DEBTOR SHOULD BE COMPELLED
TO PAY IN ADVANCE THE FAIR MARKET
VALUE OF ELECTRICITY PENDING ITS
ASSUMPTION OR REJECTION OF THE PPA**

29. On April 11, 2001, the Debtor sent Oildale a unilateral directive purporting to require that Oildale deliver energy and contract capacity (i) at the rates established in the PPA or even at a lower rate pending certain unspecified contingencies and (ii) on credit terms allowing for at least fifteen days of credit every month. (Sugaoka Dec. at Ex. E.)

30. Oildale does not have the wherewithal to perform on these terms in light of the extent of the Debtor's prepetition defaults. Moreover, the Bankruptcy Code does not entitle the Debtor to performance on the terms which it seeks.

31. First, no party, including Oildale, can be forced to extend credit to the Debtor, at least without the Debtor's assumption of the agreement that contemplates the provision of credit. If the Debtor wishes to obtain credit from a third party, its rights and those of its proposed lender are controlled by section 364 of the Bankruptcy Code. No provision is found therein (or anywhere else in the Bankruptcy Code) that could in any way be construed to give the Debtor the power to compel a proposed lender to extend credit against its will.

32. Yet, that is precisely the result that will pertain here if Oildale is able to resume operations and the Debtor is not required to pay for electricity in advance. Oildale's Facility is directly connected to the Debtor's power grid. When the Facility generates electricity, it is immediately delivered to the Debtor, which, in turn, pays for it later under the PPA.

33. Thus, absent an enforceable agreement regarding credit terms, and absent the protections of section 364 of the Bankruptcy Code, the mere fact of Oildale's postpetition operation results in an involuntary extension of credit to the Debtor -- unless the Debtor is ordered to pay Oildale in advance.

34. If Oildale were to come back online and supply electricity to the Debtor at current market prices, the Debtor would be incurring additional indebtedness to Oildale at the rate

1 of \$240,000 per day. In the first fifteen days of each month (the credit terms sought in the
2 Debtor's April 11 directive), Oildale's exposure would thus be approximately \$3.6 million.

3 35. Oildale has already been damaged enough by the Debtor's failure to meet its
4 payments and thus cannot be forced to extend further credit to the Debtor at this time.
5 Accordingly, deliveries should be pre-paid by the Debtor.

6 36. Second, as set forth in the accompanying Consolidated Memorandum,
7 pending the Debtor's decision to assume or reject the PPA, the Debtor is obligated to pay for the
8 reasonable value of Oildale's postpetition deliveries. Absent the Debtor's assumption of the PPA,
9 it is clear that the reasonable value of the electricity provided by Oildale to the Debtor is not the
10 price contemplated by the PPA, which reflects a long term commitment to purchase electricity. In
11 fact, the PPA price is significantly less than the fair market value of electricity delivered on a short-
12 term basis, and does not cover Oildale's cost of operations. (Sugaoka Dec., ¶ 15.)

13 37. The Bankruptcy Code does not permit the Debtor to withhold the \$10.5
14 million it owes Oildale, refuse to make a prompt decision to assume or reject the PPA, and then add
15 insult to injury by compelling delivery of Oildale's power at prices far below market value.

16 38. Therefore, if the Debtor elects to receive electricity from Oildale pending its
17 decision to assume or reject, it should pay in advance the fair market value for such electricity.

18 **ALTERNATIVELY, THE AUTOMATIC STAY SHOULD BE LIFTED**
19 **TO PERMIT OILDALE'S SUSPENSION OF PERFORMANCE UNDER THE**
PPA PENDING THE DEBTOR'S DECISION TO ASSUME OR REJECT THE PPA

20 39. As an alternative to the relief requested above, the Court should grant relief
21 from the automatic stay to permit Oildale to suspend its performance under the PPA pending the
22 Debtor's assumption or rejection thereof, and permit Oildale to sell electricity to creditworthy third
23 parties.

24 40. Such relief from the automatic stay is warranted under section 362(d)(1)
25 which provides that "on request of a party in interest . . . the court shall grant relief from the stay
26 provided under subsection (a) of this section . . . for cause, including the lack of adequate
27 protection of an interest in property of such party in interest." 11 U.S.C. § 362(d)(1).
28

41. Here, “cause” clearly exists for relief from the stay. There is no doubt that, unless Oildale is permitted to sell at market price, Oildale, the Debtor, and California electricity consumers will all be irreversibly harmed. Because of the Debtor’s material payment breaches under the PPA, Oildale has depleted its working capital to the point where it lacks the wherewithal to purchase gas needed for the operation of the Facility. (Sugaoka Dec., ¶ 17-19.) The Facility has been shut down and cannot be reopened on the basis of the Debtor’s unilateral offer to pay contract price (or less) on terms. (Id., 19.)

42. The Debtor's April 11 demand to pay the rates under the PPA, which may have been sufficient to keep Oildale in business under other circumstances, is entirely insufficient now that Oildale's resources have been depleted by the Debtor's past defaults. As things currently stand, the Debtor's proposal for postpetition payments pending assumption or rejection will only aggravate Oildale's dire financial situation and would most likely result in the bankruptcy of Oildale. Consequently, the Debtor will lose the PPA (which would likely be rejected in Oildale's bankruptcy) and California may be deprived of yet another power producer for the critical summer months and the current power crisis will only worsen.

43. By comparison, all constituencies will actually be benefited by Oildale's suspension. Oildale will be able to resume operations, produce electricity and mitigate its damages. The Debtor will have the ability to purchase electricity from Oildale either by assuming the PPA (which will be preserved by Oildale's ongoing viability) and curing its defaults or by paying market price for postpetition electricity delivered by Oildale. Importantly, California will have available an additional 40 megawatts of standard capacity.

CONCLUSION

44. For all the foregoing reasons, Oildale requests that this Court enter an order (i) granting Oildale's motion to compel the Debtor to promptly assume or reject the PPA and directing the Debtor to pay to Oildale market price in advance for electricity delivered to it in the interim; or (ii) granting Oildale relief from the automatic stay to allow it to suspend

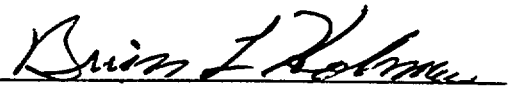
1 performance under the PPA until such time that the Debtor elects to assume or reject the PPA; and
2 (iii) granting such other and further relief as the Court deems just.

3
4 Dated this 30 day of April, 2001.

5 Respectfully Submitted,

6 WHITE & CASE LLP

7 By



8 Brian L. Holman

9 Attorneys for Oildale Energy LLC

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7
8 UNITED STATES BANKRUPTCY COURT
9 NORTHERN DISTRICT OF CALIFORNIA
10 SAN FRANCISCO DIVISION

11 In Re:
12 PACIFIC GAS & ELECTRIC COMPANY,
a California corporation,

13
14 Debtor.

15 Federal I.D. No. 94-074260
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Case No. 01-30923 DM
THE HONORABLE DENNIS MONTALI
CHAPTER 11 CASE
DECLARATION OF ALEX A. SUGAOKA IN SUPPORT OF OILDALE ENERGY LLC'S EMERGENCY MOTION FOR AN ORDER (i)(A) COMPELLING THE DEBTOR TO ASSUME OR REJECT OILDALE'S POWER PURCHASE AGREEMENT WITH THE DEBTOR ON OR BEFORE JUNE 1, 2001, AND (B) REQUIRING THE DEBTOR TO PAY FAIR MARKET VALUE IN ADVANCE FOR ALL ELECTRICITY DELIVERED BY OILDALE PENDING ASSUMPTION OR REJECTION OF ITS POWER PURCHASE AGREEMENT; OR, IN THE ALTERNATIVE (ii) GRANTING OILDALE RELIEF FROM THE AUTOMATIC STAY TO ALLOW IT TO SUSPEND PERFORMANCE UNDER ITS POWER PURCHASE AGREEMENT WITH THE DEBTOR PENDING ASSUMPTION OR REJECTION THEREOF

26 Date: May 10, 2001
27 Time: 1:30 p.m.
Place: 235 Pine Street, 22nd Floor,
San Francisco, California
28

1 I, Alex A. Sugaoka, declare and say:

2 1. I am the General Manager of the Asset Manager (UAE Energy Operations
3 Corp.) for Oildale Energy LLC ("Oildale"). I make this declaration in support of Oildale's
4 emergency motion for entry of an order (i)(A) compelling the Debtor to assume or reject the Power
5 Purchase Agreement between Oildale and the Debtor, dated March 1985, (the "PPA") on or before
6 June 1, 2001, and (B) compelling the Debtor to pay fair market value in advance for electricity
7 delivered to it by Oildale pending assumption or rejection of the PPA; or (ii) granting Oildale relief
8 from the automatic stay to allow Oildale to suspend performance under the PPA pending
9 assumption or rejection. I have personal knowledge as to the matters described in this declaration,
10 and I am competent to testify on these matters.

11 2. Oildale is structured as a single purpose company. It owns a plant in
12 Oildale, California (the "Facility") which burns natural gas to produce electrical and thermal energy.
13 The nature of its business operations is such that its operating revenues are limited to sales of
14 energy and capacity to Pacific Gas and Electric Company (the "Debtor") and sales of thermal
15 energy to a local refinery which serves as Oildale's thermal energy host. As described in greater
16 detail below, Oildale presently is not operating as a direct result of the Debtor's refusal to pay in
17 full for four months of electricity which Oildale delivered and the Debtor accepted and used.
18 Unless this situation is remedied immediately, Oildale will remain shut down for the foreseeable
19 future, depriving California consumers of another source of much needed electricity. Further,
20 unless prompt action is taken by this Court, Oildale's increasing financial distress will most likely
21 compel Oildale to file its own bankruptcy petition.

22 Background

23 3. Oildale is a cogeneration facility, producing both electrical energy and some
24 other form of useful energy, such as thermal energy. Oildale is a "qualifying facility" or "QF" as defined
25 by the Public Utilities Regulatory Policies Act of 1978 ("PURPA"), as amended, 16 U.S.C. 824a-3, et
26 seq., and the regulations enacted thereunder, which entitles it to receive certain protections and
27 exemptions under PURPA (e.g., exemption from certain state and federal utility regulations).

1 4. As a QF, Oildale is an important source of clean, reliable electricity. Under
2 PURPA, my understanding is that a QF such as Oildale is entitled to receive the electric utility's full
3 avoided cost for electricity, which is generally the incremental cost of operation that the utility would
4 have paid to generate the electricity itself or buy from a third party for the last megawatt hour of
5 electricity generated at any given time, but for the QF providing the power. These costs of operation are
6 generally referred to as the Avoided Costs (the "Avoided Costs").

7 5. The major component of Oildale's costs of operation is the price of natural gas,
8 which constitutes over 80% of Oildale's operating expenses. Oildale burns natural gas as its sole fuel to
9 produce thermal energy and electricity. The thermal energy is sold to a nearby refinery as its primary
10 source of energy for its refinery process. The Facility generates a total of 40 megawatts of electricity, an
11 amount which is sufficient to meet the power needs of about 40,000 homes in California.

12 6. Oildale is dependent upon revenue from the Debtor because it is the only
13 purchaser of Oildale's electricity. Such revenue constitutes approximately 85% of Oildale's total
14 monthly revenue. The remaining revenues are derived from the local refinery, which purchases thermal
15 energy from Oildale, serving as Oildale's thermal host. Thus, Oildale's entire operation is funded
16 from, and dependent on, the revenue from the Debtor, such that any major default under the PPA
17 seriously jeopardizes Oildale's ability to supply electrical and thermal energy.

18 The PPA

19 7. In 1985, Oildale entered into a Power Purchase Agreement (the "PPA") with a
20 term expiring in 2015 to sell the electricity generated by its facility to the Debtor pursuant to a standard
21 offer contract that the California Public Utilities Commission (the "CPUC") had adopted in 1982.
22 Attached to my declaration as Exhibit A is a true and correct copy of the PPA. In compliance with
23 PURPA, the PPA provides for energy payments based on the Debtor's "Avoided Costs" at the time of
24 delivery. See PPA, Ex. A, Article 4.

25 8. My understanding is that although the PURPA pricing benchmark of Avoided
26 Costs remains the controlling federal standard on parties to the PPA, the method of calculating the
27 avoided costs of energy in California has changed throughout the years. Initially, the utilities (e.g. the
28 Debtor) would set energy prices based upon the forecasted Avoided Costs for a three month period and

1 no adjustments were made at the end of the period, even if actual fuel gas and other price setting
2 components differed from the forecast. To refine the details of this calculation in keeping with PURPA's
3 mandates, the CPUC replaced this three month Avoided Cost energy posting with a monthly posting.
4 Later, the CPUC adopted an index for calculating the energy component of the price. This methodology
5 used the cost of the avoided fuel, natural gas for example, at a known supply location plus transportation
6 costs to California and was consistently applied for a number of years.

7 9. In 1996, California adopted electricity deregulation, which resulted in utilities
8 such as the Debtor selling off much of their own gas-fired generation. The deregulation legislation
9 (Assembly Bill 1890, codified as Public Utilities Code § 390) included a requirement that the CPUC
10 adopt an interim formula to reflect the monthly adjustment of natural gas prices at the California border.
11 After lengthy negotiations among the QFs, the utilities and the CPUC, the CPUC adopted a transition
12 formula in December 1996 (the "Transition Formula"). Attached to my declaration as Exhibit B is a
13 true and correct copy of the CPUC's Decision setting forth the Transition Formula, Dec. No. 96-12-
14 028. For the Debtor, the Transition Formula included a component for the price of natural gas (the
15 "Natural Gas Component") based on a simple average of the monthly indices for natural gas prices at
16 Malin, Oregon, the northerly intake for California (the "Malin Gas Price"), and at Topock, Arizona, the
17 primary southerly intake for California (the "Topock Gas Price"). The energy pricing formula in
18 Oildale's PPA automatically allowed for incorporation of this new formula, including the Natural Gas
19 Component which was based upon this average of the Malin Gas Price and the Topock Gas Price.

20 10. The prices of the natural gas that Oildale relies on to produce thermal energy and
21 electricity are based upon a long-term contract with prices adjusted on a monthly basis in accordance
22 with the Topock Gas Price. Gas priced for delivery to QFs in the Southern California area (which
23 includes Oildale) has typically been based on the Topock Gas Price. Since the Transition Formula was
24 adopted in 1996, the Topock Gas Price has tended to be higher than the Malin Gas Price, although the
25 disparity was not substantial until recent months. The Transition Formula moderated the difference
26 between the Topock Gas Price and the Malin Gas Prices by using the average of the prices. Therefore,
27 the difference between the gas prices used to calculate Oildale's revenues and expenses was insubstantial
28 up until recent months.

1 11. In the past year, the fuel gas price environment and fundamental gas price
2 assumptions upon which Oildale had been operating for the previous 15 years began to change
3 dramatically. First, the prices of the natural gas that were based upon the Topock Gas Price began to
4 soar to historic levels. By mid-year 2000, the Topock Gas Price had doubled when compared to the
5 January 2000 Topock Gas Price. By December of 2000, the Topock Gas Price had quintupled from its
6 January 2000 level. The Topock Gas Price during 2001 has so far not retreated to historical price levels,
7 and the forward fuel-gas-price strips indicate that these gas price indices are likely to stay robust for the
8 rest of 2001, if not longer. Therefore, Oildale's costs of operation have increased substantially in direct
9 correlation with the gas prices.

10 12. As the Topock Gas Price began to rise in June of 2000, there began to be a
11 significant disparity between the Topock Gas Price and the Malin Gas Price. This disparity began
12 widening dramatically especially in January of 2001 such that neither the Topock Gas Price nor the
13 Malin Gas Price approximated each other. In March of 2001 for example, the Malin Gas Price was
14 \$8.4667 per MMBtu and the Topock Gas Price was \$12.740 per MMBtu. Oildale was able to continue
15 providing clean, reliable energy to the Debtor during part of this period only because the Transition
16 Formula took into account Topock pricing.

17 13. The March 27, 2001 decision of the CPUC (the "Wood Decision"), which
18 became effective April 1, 2001, held that the Natural Gas Component of the Avoided Cost formula shall
19 be based solely on the Malin Gas Price rather than the average of the Malin Gas Price and Topock Gas
20 Price (The "Wood Decision Formula"). Attached to my declaration as Exhibit C is a true and correct
21 copy of the Wood Decision.

22 14. Thus, the Avoided Cost Formula changed by the Wood Decision no longer
23 yields anything close to the Debtor's true "Avoided Cost" as mandated by PURPA. If Oildale were to
24 purchase gas at Topock March 2001 prices and operate under the Wood Decision Formula, Oildale
25 would be operating at a daily economic loss. That is to say that Oildale's total revenues would be less
26 than the corresponding operating expenses such as fuel, labor and maintenance. Such operations would
27 be commercially unsustainable, eventually leading to bankruptcy of the Oildale project. It is my
28 understanding that several QFs and a trade association known as the California Cogeneration Council

1 ("CCC") have filed a petition with FERC to have the Wood Decision reviewed (the "CCC Petition"). A
2 true and correct copy of the CCC Petition is attached to my declaration as Exhibit D. There is no
3 assurance that there will be any action forthcoming from FERC in the near term.

4 15. The combined effect of the rising Topock Gas Price, the Wood Decision which
5 keys energy revenues from the Debtor solely to the Malin Gas Price, and the above described disparity
6 between the Topock Gas Price and the Malin Gas Price is that Oildale is forced to buy high (i.e., by
7 purchasing gas at the Topock Gas Price) and sell low with significant resulting losses. Currently, the
8 Wood Decision Formula stipulates electric pricing which is significantly less than market prices.
9 Payment under the Wood Decision Formula would not even support operating expenses,
10 notwithstanding Oildale's debt obligations. In April 2001, "all-in" prices under the PPA were
11 approximately \$100/MWh.

12 The Debtor's Breach of the PPA and the Resulting Effect on Oildale

13 16. The Debtor's failure to pay for the electricity that Oildale provided to it between
14 December of 2000 and March 31, 2001 has brought financial ruin on Oildale. The Debtor paid only
15 15% of the amounts owing for December 2000 and January 2001, and has paid nothing for February or
16 March 2001. As outlined in the table below, through March 31, 2001, the Debtor owes Oildale at least
17 \$10,522,581, excluding interest and possibly some capacity payments, on account of its prepetition
18 defaults with no prospect of payment of this claim in sight.

OILDALE ACCOUNTS RECEIVABLE FROM PG&E				
Billing		Payment		
Period	Amount	Period	Amount	Ending Balance
Dec-00	\$4,992,472			
Jan-01	\$5,249,945	Jan-01	\$549,097 ¹	
Feb-01	\$687,967	Feb-01	\$199,699 ¹	
Mar-01	\$1,154,659	Mar-01	\$813,666 ²	
Total	\$12,085,043		\$1,562,462	\$10,522,581

17. Oildale presently owes about \$7,167,000 to its gas supplier, Duke Energy Fuels ("Duke") for gas provided in the months of December 2000 through March 2001. Duke has sent to Oildale a default and potential cancellation letter. Oildale is also in default under its agreement with Duke for not providing a letter-of-credit of \$5,379,000 as stipulated by the gas supply agreement with Duke for credit support for gas deliveries. Therefore, Oildale's cash obligations for gas supply alone are over \$12 million. Oildale is also at risk for substantial third party claims from Duke. Continued non-operation exacerbates its risk with Duke and the local refinery. The local refinery has also been economically affected by Oildale's lack of operation and has recently laid off 31 hourly workers from its refinery primarily due to Oildale's lack of operation and, on April 23, was forced to declare bankruptcy itself.

18. Oildale is in default on its \$2,500,000 outstanding working capital loan. Oildale is also in default on its senior debt loan and property taxes and is at risk of foreclosure and bankruptcy.

19. Oildale was forced to shut down its plant on February 6, 2001 as Oildale was unable to become current on outstanding gas invoices or provide assurances of payment in the near future. Assurances could not be provided to Duke directly due to the Debtor's inability to perform

¹ Refers to partial payment on December 2000 billing.

² Refers to partial payment on January 2001 billing.

1 on then-current defaults or provide assurances of payment going forward. Oildale operated for 10
2 days in March primarily using cash from the Debtor's 15% payment for January energy deliverables
3 to pre-pay for gas supplies. Cash is now substantially exhausted. The current balance in Oildale's
4 unrestricted accounts is about \$250,000 and is projected to run out on May 15, 2001. Oildale lacks
5 adequate cash or credit to pay for or assure Duke of payment for future gas deliveries to restart
6 operations.

7 The Debtor's Postpetition Plans


8 20. It is not at all clear what amounts the Debtor intends to pay to Oildale for its
9 electricity on a go forward basis. Additionally, the Debtor has not provided adequate assurances
10 showing any ability to pay any amounts to Oildale. Even if the Debtor pays under the Wood Formula, it
11 is not enough to support Oildale's variable costs of operation or to keep Oildale operating economically.
12 Finally, Oildale does not have any assurance that the Debtor could make up either the historical or go
13 forward amounts that would become due and owing to Oildale if FERC (or some other entity) acts to
14 alter the impact of the Wood Decision.

15 21. On April 11, 2001, the Debtor sent Oildale a unilateral directive requiring that
16 Oildale deliver energy and contract capacity to the Debtor (i) at the rates established in the PPA or even
17 at a lower rate, pending certain unspecified contingencies and (ii) on credit terms allowing for at least 15
18 days of credit each month. A true and correct copy of the April 11 directive is attached hereto as Exhibit
19 E.

20 22. If Oildale were to come back online and supply power to the Debtor at market
21 prices, the Debtor would be indebted to Oildale at the rate of about \$240,000 per day. In the first 15
22 days of each month (the credit sought), Oildale's exposure would be approximately \$3.6 million. The
23 amounts that Debtor seeks to pay Oildale for electricity are insufficient to cover the costs of fuel and
24 other operating expenses such as labor and maintenance, much less satisfy the debt going forward or that
25 created by Debtor's prepetition breaches. Moreover, the credit terms upon which Debtor seeks to pay
26 Oildale would also render Oildale unable to perform in light of Debtor's prepetition defaults because
27 Oildale would be unable to provide the assurances of payment required by its creditors to resume
28 operations.

1 I declare under penalty of perjury under the laws of the United States and the state of
2 California that the foregoing is true and correct.

3 Dated this 30 day of April, 2001, at San Ramon, California.

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6 Alex A. Sugaoka

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DECLARATION OF ALEX A. SUGAOKA IN
SUPPORT OF OILDALE ENERGY LLC'S MOTION

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10 Attorneys for Oildale Energy LLC, Wadham Energy LP, and
11 KES-Kingsburg LP

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

17 In re
18
19 PACIFIC GAS & ELECTRIC
20 COMPANY, a California corporation,
21
22 Debtor.

23 Federal I.D. No. 94-074260

24 Case No. 01-30923 DM
25 THE HONORABLE DENNIS MONTALI
26 CHAPTER 11 CASE
27
28 CONSOLIDATED MEMORANDUM OF
POINTS AND AUTHORITIES IN
SUPPORT OF THE EMERGENCY
MOTIONS OF OILDALE ENERGY LLC,
WADHAM ENERGY LP, AND
KES-KINGSBURG, LP FOR ENTRY OF
AN ORDER (i)(A) COMPELLING THE
DEBTOR TO ASSUME OR REJECT EACH
MOVANT'S POWER PURCHASE
AGREEMENT WITH THE DEBTOR ON
OR BEFORE JUNE 1, 2001, AND
(B) REQUIRING THE DEBTOR TO PAY
FAIR MARKET VALUE IN ADVANCE
FOR ALL ELECTRICITY DELIVERED BY
THE MOVANTS PENDING ASSUMPTION
OR REJECTION OF THEIR POWER
PURCHASE AGREEMENTS OR, IN THE
ALTERNATIVE, (ii) GRANTING THE
MOVANTS RELIEF FROM THE
AUTOMATIC STAY TO SUSPEND
PERFORMANCE UNDER THEIR POWER
PURCHASE AGREEMENTS WITH THE
DEBTOR PENDING ASSUMPTION OR
REJECTION THEREOF

Date: May 10, 2001
Time: 1:30 p.m.
Place: 235 Pine Street, 22nd Floor
San Francisco, CA

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<u>In re Taber Farm Associates,</u> 115 B.R. 455 (Bankr. S.D.N.Y. 1990)	18
<u>In re Western Pacific Airlines, Inc.,</u> 1998 Bankr. LEXIS 1964 (Bankr. D. Colo. Dec. 11, 1998)	9
<u>Matter of Dunes Casino Hotel,</u> 63 B.R. 939 (D. N.J. 1986)	18
<u>Matter of Gasmark Ltd.,</u> 193 F.3d 371 (5th Cir. 1999)	9
<u>Matter of Washington-St. Tammany Electric Cooperative, Inc.,</u> 111 B.R. 555 (Bankr. E.D. La. 1989)	11, 13
<u>National Labor Relations Board v. Bildisco and Bildisco,</u> 465 U.S. 513, 104 S. Ct. 1188 (1984)	9

1	<u>Otto Preminger Films, Ltd. v. Qintex Entm't, Inc. (In re Qintex Entertainment, Inc.),</u>	20
2	950 F.2d 1492 (9th Cir. 1991)	
3	<u>Packerland Packaging Co., Inc. v. Griffith Brokerage Co. (In re Kemble),</u> 776 F.2d 802	20
4	(9th Cir. 1985)	
5	<u>Peoples Gas System, Inc. v. Thatcher Glass Corp. (In re Thatcher Glass Corp.),</u>	11, 12
6	59 B.R. 797 (Bankr. D. Conn. 1986)	
7	<u>Public Service Co. of New Hampshire v. New Hampshire Electric Coop.,</u>	13
8	83 F.E.R.C. ¶ 61,224, 1998 WL 272964 (1998)	
9	<u>S.N.A. Nut Co. v. Haagen-Dazs Co. (In re S.N.A. Nut Co.),</u> 191 B.R. 117	10
10	(Bankr. N.D. Ill. 1996)	
11	<u>Sharon Steel Corp. v. National Fuel Gas Distribution Corp.,</u> 872 F.2d 36	10, 11, 12
12	(3d Cir. 1989)	
13	<u>Skeen v. Coca-Cola Bottling Co. (In re Feyline Presents, Inc.),</u> 81 B.R. 623	10
14	(Bankr. D. Colo. 1988)	
15	<u>Theatre Holding Corp. v. Mauro,</u> 681 F.2d 102 (2d Cir. 1982)	18
16	<u>Thompson v. IFG Leasing Co. (In re Thompson),</u> 788 F.2d 560 (9th Cir. 1986)	10
17	<u>Towers v. Chickering & Gregory (In re Pacific-Atlantic Trading Co.),</u> 27 F.3d 401	10
18	(9th Cir. 1993)	
19	<u>Transamerica Commercial Finance Corp. v. Citibank, N.A.</u>	16
20	(In re Sun Runner Marine, Inc.), 945 F.2d 1089 (9th Cir. 1991)	
21	<u>Tuscon Estates, Inc. v. Christensen (In re Tucson Estates, Inc.),</u> 912 F.2d 1162	20
22	(9th Cir. 1990)	
23	<u>United Savings Association of Texas v. Timbers of Inwood Forest Associates Ltd.</u>	15
24	(In re Timbers of Inwood Forest Associates Ltd.), 808 F.2d 363 (5th Cir. 1987)	
25	<u>United States v. Consumer Health Services of America, Inc.,</u> 108 F.3d 390	9
26	(D.C. Cir. 1997)	
27	<u>United States v. Ron Pair Enterprises, Inc.,</u> 489 U.S. 235 (U.S. 1989)	17
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STATUTES

24	11 U.S.C. § 362	20
25	11 U.S.C. § 364(a)	15
26	11 U.S.C. § 365(b)	17

1	11 U.S.C. § 365(b)(1)	14, 16, 18
2	11 U.S.C. § 365(d)(2)	18
3	16 U.S.C. § 824(a)(3), <u>et seq.</u>	6

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1 Oildale Energy LLC ("Oildale"), Wadham Energy LP ("Wadham"), and KES-
2 Kingsburg LP ("Kingsburg," and collectively with Oildale and Wadham, the "Movants")
3 respectfully submit this consolidated memorandum of points and authorities in support of their
4 respective separate motions for entry of an order (i)(A) compelling the Debtor to obtain an order
5 authorizing the assumption or rejection of their power purchase agreements by June 1, 2001, and
6 (B) directing the Debtor to pay fair market value in advance for all electricity the Movants deliver
7 to the Debtor prior to the assumption or rejection of their power purchase agreements, or (ii) in the
8 alternative to the foregoing relief, granting the Movants relief from the automatic stay to suspend
9 their performance under the power purchase agreements pending assumption or rejection and
10 authorizing them to sell electricity to third parties during such period of time (collectively, the
11 "Motions").

12 13 PRELIMINARY STATEMENT

14 The Movants operate power plants, commonly referred to as "qualified facilities" or
15 "QFs," that (a) in the case of Oildale and Kingsburg, produce two types of energy by burning
16 natural gas: (1) electricity, which they sell to Pacific Gas & Electric Company ("PG&E" or the
17 "Debtor") under long-term power purchase agreements, commonly referred to as "PPAs," and (2)
18 thermal energy, which they sell to nearby thermal hosts, and (b) in the case of Wadham, burns rice
19 hulls to produce electricity and usable by-products. Historically, the relationship between the QFs
20 and PG&E was one of mutual dependence. Pursuant to its QF contracts, PG&E received a
21 reliable source of approximately 4,500 megawatts of electrical capacity (which comprises
22 approximately 33% of its total capacity, or enough electricity to power approximately 4.5 million
23 California homes). Concomitantly, the QFs received from PG&E a long-term commitment to
24 purchase their electric power production, which has supported the QFs' operations and financing.

25 Over the past year, however, this balanced relationship was thrown into a state of
26 near-total chaos as energy costs unexpectedly sky-rocketed without matching adjustments to the
27 rates PG&E charges its customers. Faced with ever-mounting losses from operations and a
28 shortage of electricity, PG&E became unable (or unwilling) to provide uninterrupted electrical

1 service to the public. Sporadic brown-outs followed as California plunged into an all-out energy
2 crisis. The state was forced to step in to fill the gaps by purchasing electricity which was then
3 delivered to the public through PG&E's power grid.

4 Without explanation, PG&E then turned on its QFs. Even though the PPAs entitle
5 PG&E to purchase electricity at prices that are currently substantially below market, in December
6 2000 PG&E chose to curtail and then terminate altogether payments to the QFs. Unable to access
7 alternative purchasers of their electricity, the QFs (perhaps naively) fully upheld their end of the
8 bargain by continuing to produce and deliver electricity to PG&E to the extent they were able to do
9 so without receiving payment. Through this strategy of accepting the QFs' electricity production
10 but not paying for it, by April 6, 2001 (the "Petition Date"), PG&E had built a substantial war chest
11 including nearly \$1.0 billion which it had withheld from its QFs.

12 The result has been near devastation to the QF community. Of the 9,000 megawatts
13 of electric capacity provided by QFs in the State of California, on the date hereof, approximately
14 3,000 megawatts was off-line, unable to operate as a direct result of the tactics employed by PG&E
15 and Southern California Edison (which has also accepted electricity from the QFs without making
16 payment therefor). Financial defaults loom for many QFs and individual QF bankruptcies appear
17 ready to breakout across the state.

18 To make matters worse, shortly after commencing its chapter 11 case, PG&E issued
19 a unilateral directive to the QFs pursuant to which the QFs were informed that (1) they were to
20 continue providing electricity to PG&E under their PPAs, (2) the QFs would be paid the contract
21 rate as recently reset by the California Public Utility Commission (or less, if required by the
22 exigencies of PG&E's situation), (3) payments would be made 15 days in arrears, and (4) the
23 foregoing rules of engagement would continue indefinitely on a month-to-month basis, until further
24 notice. In short, not only would PG&E oblige itself of the favorable pricing provided by the QFs'
25 long-term PPAs, without reaffirming PG&E's long-term commitment to the QFs, but also the QFs
26 were to be compelled, against their will, to increase their exposure to PG&E's insolvency by
27 extending new postpetition credit to PG&E -- without an enforceable agreement to extend such
28 credit, and without any of the protections afforded by section 364 of the Bankruptcy Code.

1 This Court must serve as the throttle on the Debtor's pernicious behavior. Failure
2 to do so would be inconsistent with what should be the primary objective of all concerned: making
3 sure that California has as much electrical capacity on line during the high-use summer months as is
4 available. Simply put, the Debtor cannot "have its cake and eat it, too." The Debtor cannot
5 receive on an indefinite basis the full benefits of PPAs that were priced and structured on the
6 Debtor's long-term commitment to purchase power, without reaffirming its long-term commitment
7 and curing its defaults. The Debtor's scheme unfairly exposes the QFs to the prospect of losing
8 billions of dollars in the aggregate while energy prices remain at all-time highs, without the ability
9 to recoup such losses when energy prices normalize in the future. Presumably, the moment that
10 happens, the Debtor will announce that the PPAs are burdensome and reject them, forcing the QFs
11 to sell at then-market prices, with little or no profit to offset the previously-incurred losses. The
12 Debtor's scheme also provides the Debtor with the improper windfall of long-term pricing (with
13 built-in credit terms) -- without having to be party to an enforceable long-term contract.

14 These results are simply not sanctioned by the Bankruptcy Code. Pending
15 assumption or rejection of the PPAs, the Debtor must pay the fair market value of the electricity
16 delivered by the QFs without credit terms (i.e., payment must be made in advance), unless a QF
17 otherwise agrees.

18 Beyond being legally untenable, the Debtor's scheme is impossible from a practical
19 perspective. Many of the QFs, including the Movants, do not have the wherewithal to operate on
20 the terms dictated by the Debtor. Ultimately, they will be forced to cease operations (if they have
21 not already done so) and to seek their own bankruptcy protection. The results: inoperative
22 electrical capacity critically needed in the State of California; doubtlessly, a proliferation of
23 litigation; massive claims by the QFs against the Debtor's estate; and the vitiation of the PPAs as to
24 which the Debtor purportedly seeks to reserve its right to assume or reject.

25 To avoid such a disastrous outcome, the Court should either (1) compel the Debtor
26 to (a) promptly assume or reject the PPAs, and (b) pending such assumption or rejection, pay fair
27 market value in advance for all electricity delivered postpetition by the Movants, or (2) in the
28 alternative, lift the automatic stay so that the Movants may suspend performance under the PPAs

1 and sell electricity to third parties at market pending the Debtor's assumption or rejection thereof.
2 In addition, in either event, the Debtor should be ordered to pay immediately as an administrative
3 expense under section 503(b) of the Bankruptcy Code the difference between contract price and
4 fair market value for all electricity delivered by QFs from the commencement of this chapter 11
5 case until the entry of orders on the Motions. Such relief will:

- 6 • permit the QFs to resume and/or sustain operations during this Chapter 11
7 case;
- 8 • maximize the amount of electrical capacity available in the State of
9 California;
- 10 • limit (or perhaps even eliminate) the further build-up of QF claims against
11 the Debtor's estate;
- 12 • permit this Court to retain centralized control over the issues that exist or
13 may arise between the Debtor and the QFs (promoting judicial efficiency and ensuring
14 a consistent outcome with respect to all QFs); and
- 15 • preserve the viability of the PPAs pending the Debtor's decision to assume
16 or reject them.

18 STATEMENT OF FACTS

19 As noted above, this consolidated memorandum is submitted in support of three
20 motions brought by three separate QFs: Oildale, Wadham, and Kingsburg. Each Motion is
21 supported by the declaration of an officer or representative of the individual Movant setting forth
22 the facts germane to each Motion.¹

23 Oildale is a single purpose limited liability company formed for the purpose of
24 owning and operating a 40 megawatt ("MW") cogeneration facility in Oildale, California (the

25 ¹ Those declarations are as follows: (i) Declaration of Alex A. Sugaoka, dated April 30, 2001,
26 submitted in support of Oildale's motion ("Oildale Dec."), (ii) Declaration of Alex A. Sugaoka,
27 dated April 30, 2001, submitted in support of Wadham's motion ("Wadham Dec."); and (iii)
28 Declaration of James Hinrichs, dated April 30, 2001 submitted in support of Kingsburg's motion
("Kingsburg Dec.").

1 "Oildale Facility"), which burns natural gas to produce electricity and thermal energy. (Oildale
2 Dec. ¶¶ 2, 3, 5). Wadham is a single purpose limited partnership formed for the purpose of owning
3 and operating a 26.5 MW facility in Williams, California, which burns rice hulls to produce
4 electricity. (Wadham Dec. ¶¶ 2, 3, 5). Kingsburg is a special purpose limited partnership formed
5 for the purpose of leasing and operating a 34.5 MW facility in Fresno County, California, which
6 burns natural gas to produce electricity and thermal energy. (Kingsburg Dec. ¶¶ 2, 3, 5). Each of
7 the Movants' facilities is a "qualifying facility" as defined in the Public Utilities Regulatory Policies
8 Act of 1978, as amended, 16 U.S.C. § 824(a)(3), et seq. ("PURPA").

9 Each Movant is a counterparty to a PPA with PG&E, which is attached as Exhibit A
10 to the relevant declaration. The PPAs run for terms of between fifteen years (in the case of
11 Wadham) and thirty years (in the case of Kingsburg and Oildale), with the first PPA (Wadham) set
12 to expire in 2004 and the last (Kingsburg) in 2019. Pursuant to the PPAs, the Movants are
13 required to provide a specified amount of electricity to PG&E at certain times of the year and are
14 entitled to "put" power to PG&E at other times. In consideration for the QFs' annual commitment
15 to deliver electricity and the actual deliveries thereof, the Movants are entitled to a package of
16 compensation consisting generally of a "capacity" payment and an "energy" payment. The former
17 is set at a stipulated amount in each PPA, and the latter is set at PG&E's "Short Run Avoided
18 Cost," or "SRAC," as that rate is set by the California Public Utilities Commission (the "CPUC")
19 from time to time. "All-in" prices under the Movants' PPAs were approximately \$100/MWh in
20 April 2001. (E.g., Oildale Dec. ¶ 15).

21 Each Movant's sole or primary source of income is its PPA with PG&E.
22 Accordingly, the viability of the Movants' operations (and their ability to generate electricity) is
23 now, and has always been, dependent on the Debtor fulfilling its obligations under the PPAs. In
24 addition, each Movant has financed the development, construction and operation of its facility with
25 third-party financing based on and structured around the Movant's PPA. Thus, the failure of the
26 Debtor to pay for delivered electricity as contemplated by the PPA not only jeopardizes the
27 operation of each Movant's facility, but also it exposes each Movant to the potential exercise of
28 remedies by its lenders, and concomitantly, the prospect of bankruptcy.

1 Beginning with electricity delivered in December 2000, PG&E elected not to pay
2 what it owed for energy and capacity delivered by QFs (including the Movants), first paying a small
3 fraction of the amount due and then stopping payment entirely. As a consequence, as of the
4 Petition Date, PG&E had accrued debts to the Movants in the following amounts:

5	Oildale	\$10,522,581
6	Wadham	\$ 7,796,588
7	Kingsburg	\$10,359,900

8 Notably, despite PG&E's material defaults, the Movants continued to purchase fuel, convert that
9 fuel to electricity and deliver that electricity to PG&E -- unless and until their own financial
10 condition dictated otherwise. As a result, the Movants soon found themselves in the unsavory
11 position of having incurred material obligations related to the operation of their facilities, but
12 having no income stream available to make payments associated with those obligations. E.g.,
13 Oildale Dec. ¶¶ 16-19).

14 The Debtor's prepetition defaults have decimated the business operations of the
15 Movants. Oildale and Kingsburg, both of which are leveraged projects specifically structured
16 around cash flow from the PPAs, are currently shut down and, absent relief as requested in the
17 Motions, may well be compelled to obtain bankruptcy protection in the near future. (Oildale Dec. ¶
18 2; Kingsburg Dec. ¶ 2). Wadham has been able to remain marginally operational, but is also at risk
19 of bankruptcy: its unrestricted cash reserves have dwindled down to only \$100,000 and it will not
20 be able to meet its debt service obligations to its lender. (Wadham Dec. ¶¶ 15-16). Notably, the
21 problems being suffered by the Movants are indicative of the current condition of the overall
22 California QF industry. Of the approximately 9,000 MW of QF capacity in California, as of the
23 date of the Motion, approximately 3,000 MW is shut down and not operating. Without a sensible
24 remedy, the loss of capacity will continue to increase -- precisely as the high-demand summer
25 season comes into full swing.²

26
27 ² In addition, PG&E's defaults are beginning to have a "ripple effect" throughout California.
28 For example, the purchaser of Oildale's thermal energy has just filed for chapter 11 protection
(continued...)

1 In that regard, the Debtor's postpetition conduct with respect to the QFs is either
2 calculated to insure the further deterioration of QF power deliveries or reflective of gross and
3 wanton negligence on the Debtor's part. By letter dated April 11, 2001 (the "April Directive") and
4 addressed to all of the Debtor's QFs, the Debtor unilaterally notified the QFs that (1) they would be
5 required to continue delivering electricity under their PPAs, (2) they would be paid the contract
6 rate (as per the CPUC's March 27, 2001 rate-setting decision) for such deliveries (which rate
7 reflects a material discount to market), or an even further reduced amount, if the Debtor's
8 circumstances require, (3) payment would be made 15 days in arrears, and (4) the arrangement
9 would be continued on a month-to-month basis, pending further notice from the Debtor.
10 Juxtaposed against the fact that the Debtor had withheld approximately \$1.0 billion in payments to
11 QFs prior to commencing its chapter 11 case, the April 11 Directive makes one thing clear: the
12 Debtor's current scheme, whether the product of malice or ignorance, will only worsen California's
13 energy crisis as an ever-increasing number of QFs are forced to go off-line.

14 ARGUMENT

15 I.

16 THE DEBTOR MUST PAY THE MOVANTS THE REASONABLE 17 VALUE OF THEIR POSTPETITION DELIVERIES MADE PRIOR 18 TO ASSUMPTION OR REJECTION OF THE PPAs

18 In its April 11 Directive, PG&E has instructed that its QFs, including the Movants,
19 continue delivering electricity and capacity prior to a decision to assume or reject the PPAs.
20 Further, PG&E has stated that it will pay for such deliveries in arrears on a rolling fifteen day basis
21 at the prices purportedly established in the PPAs (unless the Debtor's circumstances cause it to
22 believe it needs to pay a lesser amount). (Oildale Dec. Ex. E). The Debtor's proposal, however,
23 side-steps and fails to address the fundamental legal issue raised by the Debtor's bankruptcy filing
24 vis á vis the QFs and the PPAs: At what price and on what other terms can the Movants and the
25 other QFs be required to perform prior to PG&E's election to assume or reject the PPAs?

26 (... continued)

27 purportedly in large part due to its inability to obtain thermal energy from Oildale. Numerous
28 other dependent businesses will be soon to follow as the QFs' conditions worsen.

1 In National Labor Relations Bd. v. Bildisco and Bildisco, 465 U.S. 513, 104 S. Ct.
2 1188 (1984), the U.S. Supreme Court answered part of that question as follows:

3 If the debtor in possession elects to continue to receive benefits from
4 the other party to an executory contract pending a decision to reject
5 or assume the contract, the debtor-in-possession is obligated to pay
6 for the reasonable value of those services.

7 Id., 465 U.S. at 531 (emphasis added). See also Matter of Gasmark Ltd., 193 F.3d 371, 374 (5th
8 Cir. 1999); United States v. Consumer Health Servs. of Am., Inc., 108 F.3d 390, 393 (D.C. Cir.
9 1997). The “reasonable value” rule rests on the premise that, during the stub period prior to
10 assumption or rejection, the parties to an executory contract have no “contract price” per se which
11 governs the purchase or sale of their goods or services. Thus, there is no extant basis upon which
12 the non-debtor party may bring an “action on the price” for postpetition performance. On the other
13 hand, the debtor is clearly not entitled to compel performance and then take the non-debtor’s goods
14 or services without compensation, as that would constitute both a due process violation and an
15 unjust enrichment of the debtor. See, e.g. Burlington Northern R.R. Co. v. Dant & Russell, Inc.
16 (In re Dant & Russell, Inc.), 853 F.2d 700, 707 (9th Cir. 1988) (“[T]he debtor-in-possession or
17 trustee’s liability for [reasonable value] is not compensatory but rather is founded upon the
18 equitable principle of preventing unjust enrichment.”); Continental Energy Assocs. Ltd. P’ship v.
19 Hazleton Fuel Mgmt. Co. (In re Continental Energy Assocs. Ltd. P’ship), 178 B.R. 405, 407
20 (Bankr. M.D. Pa. 1995) (“While we are concerned about the Fifth Amendment rights of an entity to
21 be compensated for property, the fact that the Debtor is now paying [movant] the contract amount
22 in advance, together with a court commitment that that compensation should be at least as much as
23 determined to be a ‘reasonable amount,’ suggests that [movants’] Fifth Amendment rights are
24 vigilantly being guarded by this court.”). Other courts have emphasized that a central purpose of
25 the “reasonable value” rule is to encourage creditors to supply necessary resources to a debtor
26 postpetition. See In re Western Pac. Airlines, Inc., 1998 Bankr. LEXIS 1964 (Bankr. D. Colo.
27 Dec. 11, 1998) (collecting cases).

28 To promote these various goals, courts have found and imposed an obligation on a
debtor’s part to pay for postpetition performance under any executory contract on a quantum

meruit basis - - essentially that which the common law would imply where deliveries were requested and made with no agreement in place. See, e.g. S.N.A. Nut Co. v. Haagen-Dazs Co. (In re S.N.A. Nut Co.), 191 B.R. 117 (Bankr. N.D. Ill. 1996) (extending Bildisco analysis to sales contract); In re Providence Tel. Ltd. P'ship d/b/a WSTG-TV 64, 113 B.R. 446, 451 (Bankr. N.D. Ill. 1990) (brokerage agreement); Skeen v. Coca-Cola Bottling Co. (In re Feyline Presents, Inc.), 81 B.R. 623, 626 (Bankr. D. Colo. 1988) (promotion and exclusive rights agreement).

In determining the actual quantum meruit, or "reasonable," value of postpetition performance in the stub period between assumption and rejection, the Ninth Circuit has stated,

When a lease is ultimately rejected but its interim continuance was an actual and necessary cost and expense of the estate, the allowable administrative expense is valued not according to the terms of the lease, but under an objective worth standard that measures the fair and reasonable value of the lease. The rent reserved in the lease is presumptive evidence of fair and reasonable value, but the presumption may be rebutted by demonstrating that the reasonable worth of the lease differs from the contract rate.

The actual value or benefit conferred on the debtor is not the object of the reasonable worth inquiry. Rather, the fair and reasonable value of the lease upon the open market must control. Fair market value may be determined by expert testimony if, in the discretion of the trial court, it is warranted in the circumstances of a particular case.

Thompson v. IFG Leasing Co. (In re Thompson), 788 F.2d 560, 563 (9th Cir. 1986) (emphasis added) (citations omitted). See also In re Dant & Russell, Inc., 853 F.2d at 707.³

Thus, according to the teachings of both Thompson and Dant & Russell, prior to a debtor's decision to assume or reject an executory contract or lease pursuant to section 365, the contract rate does not control where there is a demonstrable divergence between "contract" and "market" rates; under such circumstances, "market" controls. See also Sharon Steel Corp. v. National Fuel Gas Distribution Corp., 872 F.2d 36, 42 (3d Cir. 1989) (discussing interplay between

³ Notably, section 365(d)(3) (governing payment of rent under non-residential real property leases) was found to be inapplicable in both Thompson and Dant. As such, the level of administrative expense in each (market rate) was determined according to the general principles of section 503(b)(1), not the specific provisions of section 365(d)(3), which explicitly requires payment at the contract rate pending assumption or rejection. See Towers v. Chickering & Gregory (In re Pacific-Atlantic Trading Co.), 27 F.3d 401, 403 (9th Cir. 1993).

1 contract and market prices during stub period); Collett Ventures, Inc. v. Inexo Oil Co., 1990 U.S.
2 Dist. LEXIS 7444 (W.D. Mo. June 8, 1990) (discussing presumptions and rebutting of
3 presumptions in context of postpetition performance valuations).

4 The application of a market price over the contract price occurs most frequently in
5 the context of executory contracts involving long-term contractual commitments, such as energy
6 supply contracts like the PPAs in the present case. In these cases, where pricing and other terms
7 are presumably based upon expectations of multi-year performance, the long-term contract rate
8 generally will be found not to reflect accurately the market value of short-term postpetition
9 commitments in the stub period. Almost unanimously, courts which have addressed the
10 postpetition, pre-assumption/rejection status of long-term contracts have jettisoned the contract
11 price in favor of "market value" as the better indicator of the "reasonable value" postpetition
12 performance demanded by the debtor. See e.g., Sharon Steel Corp., 872 F.2d at 43 (debtor was
13 permitted to avoid an over-market contract in the stub period and obtain gas at the price that "other
14 non-contract industrial customers would have paid . . . during the relevant period."); Matter of
15 Washington-St. Tammany Elec. Coop., Inc., 111 B.R. 555 (Bankr. E.D. La. 1989); Peoples Gas
16 Sys., Inc. v. Thatcher Glass Corp. (In re Thatcher Glass Corp.), 59 B.R. 797 (Bankr. D. Conn.
17 1986).

18 Notably, the focus on market prices, not contract prices, works both ways --
19 irrespective of whether a particular executory contract is above or below market, the debtor must
20 pay "market" during the period prior to assumption or rejection. For example, in Thatcher Glass, a
21 case which was cited with approval in Sharon Steel, the debtor had entered into a year-long natural
22 gas contract with a gas distributor. When the debtor sought to compel the distributor to provide
23 gas postpetition at the contract rate, and not the higher rates the distributor had in place for short-
24 term purchases, the distributor sought an order compelling payment at the higher rate. Ultimately,
25 the Court agreed with the distributor:

1 If this were any other contract for the bulk purchase of goods, discounted
2 because of minimum purchase requirements, and the contract were rejected
3 by a debtor under bankruptcy law, the reasonable value of the goods
delivered prior to rejection would be what the debtor would have to pay
for them under market conditions at the time of delivery.

4 The reasonable value of the natural gas delivered post-petition to Thatcher
5 is what Thatcher would have to pay for it. There is no question but that
6 Thatcher would have to pay at the [short-term] rate for the delivery of gas
7 for less than one year. Thatcher bargained for a reduced rate and got it
because, among other conditions, it qualified by promising to purchase an
annual minimum volume of natural gas. Thatcher seeks to assume the
[long-term rate] and reject the rest of the contract, a practice which has
been disallowed by other courts and will not be permitted here.

8 * * *

9 The trustee . . . may not blow hot and cold. If he accepts the contract he
10 accepts it cum onere. If he receives the benefits he must adopt the
burdens. He cannot accept one and reject the other.

11 Thatcher Glass, 59 B.R. at 800 (citations omitted) (emphasis provided).

12 In an even more factually similar case to the matter sub judice, the Bankruptcy
13 Court for the Eastern District of Louisiana established a market-based procedure for determining
14 the "reasonable value" of electricity delivered postpetition by a non-utility generator to a debtor
15 engaged in purchasing and selling wholesale electric power. In that case, the court stated,

16 The question remains . . . whether the administrative expenses are to be
17 allowed at the full contractual rate or at some other reasonable or fair
18 market rate. In In re Thatcher Glass and In re Sharon Steel, the courts
19 noted that "reasonable value" involving utility service must take into
20 account any contract rate and the regulated rates charged to customers
21 other than the debtor. In fact, the court in Thatcher Glass found that the
22 contract rate was below the reasonable value of the service when compared
to the regulated industrial rate and allowed the higher regulatory rate as an
administrative expense. In Sharon Steel, the contract involved required the
debtor to take a minimum amount of gas each month and provided a
minimum demand charge, which the regulated rate for individual customers
did not. Thus, the court in that case allowed the administrative expenses at
the regulated rate.

23 * * *

24 In this case, the reasonable or fair market value of the service in question
25 is more difficult to determine than in the previously cited cases. The only
26 rates available for comparison to the rate of the Contract are those
27 ostensibly available to debtor on the "free market" outside of the
cooperative system. In examining these rates, the court has attempted to
review the testimony of the experts without regard to demand or energy
charges, but rather in view of the average cost of electricity per kwh.

1 Washington-St. Tammany, 111 B.R. at 560. In that case, the Court looked first to market prices,
2 compared them to the contract prices, and ultimately found the two somewhat consistent. Thus,
3 the market prices, in and of themselves, were insufficient to overcome the presumption that the
4 contract rate was "reasonable," and the Court allowed an administrative claim at the contract rate.

5 Based on the foregoing authorities, it is apparent that PG&E may not compel the
6 Movants to perform postpetition with the stipulation that they accept the contract rates set forth in
7 the PPAs. Rather, the Movants are entitled to the "reasonable value" of their deliveries, likely to be
8 measured on a cents/kwh basis, for the period between the Petition Date and the date PG&E elects
9 to assume or reject the PPAs. In that regard, and without becoming overly technical, the Federal
10 Energy Regulatory Commission recently clarified that the provisions of PURPA (and implementing
11 regulations) which requires utilities to purchase electric energy and capacity from QFs at rates
12 equal to the utility's "avoided costs"

13 creates no 'right to purchase' in the directly connected utility, nor does it create an
14 obligation on the part of the QF to sell to the directly connected utility. It provides
15 only that the utility obligated to purchase power from a QF may seek, with the QF's
consent, to transmit the energy to another utility.

16 See Public Serv. Co. of New Hampshire v. New Hampshire Elec. Coop., 83 F.E.R.C. ¶ 61,224,
17 1998 WL 272964 (1998).

18 In light of the foregoing, PG&E's payment at market rates for postpetition pre-
19 assumption/rejection deliveries makes perfect sense. Pursuant to the PPAs, PG&E and its QFs
20 (with the CPUC's supervision) agreed to a pricing and payment structure which accounted for
21 long-term amortization of fixed costs and expenses, such as term debt, which would not have been
22 possible with a shorter contract term. Now, by requesting month-to-month performance, PG&E
23 has effectively curtailed the term of the PPAs from thirty years to thirty days. To require
24 performance at the long-term price, as PG&E directs, would allow PG&E to assume partially, on
25 an interim basis, the benefit of long-term pricing and payment structures, while simultaneously
26 rejecting essential terms which made those structures possible – i.e., the long-term commitment to
27 purchase. Clearly, if PG&E wants the lower price – and there is every reason for PG&E to want
28 electric power at prices which are currently substantially below market – it must assume the PPAs.

1 It cannot, however, "blow hot and cold" and selectively assume and reject particular provisions in
2 the PPAs.

3 PG&E's strategy of underpaying the QFs is particularly inappropriate to the extent
4 that it perceives that market prices will fall to more traditional levels over the next few years. In
5 such a case, a delay of assumption or rejection is directly at the expense of the QFs. If PG&E
6 assumes the PPAs, it must cure the prepetition defaults, commit to purchase the QFs' power for the
7 remainder for the PPA's terms and provide adequate assurances of its ability to do so. 11 U.S.C.
8 § 365(b)(1). On the other hand, if it rejects the PPAs, it must immediately commit itself to
9 purchase replacement electricity and capacity at market prices from third parties who will exact
10 market prices and terms. If PG&E is allowed an open-ended period in which it can compel the QFs
11 to deliver energy and capacity at the contract rate while the market is high and the right to reject
12 when the market is low, PG&E gets the best of both worlds -- a month-to-month commitment at a
13 long-term contract rate with the flexibility of being allowed to reject the PPAs at a later date when
14 market prices fall. Nothing in the Bankruptcy Code permits a debtor to restructure its operations
15 on the backs of counterparties to executory contracts. If market prices are currently above contract
16 prices, the counterparties (here, the QFs) are entitled to the benefits of those market prices, not
17 PG&E -- unless and until PG&E assumes the PPAs.

18 Accordingly, the Court should enter an Order (a) directing the Debtor to pay fair
19 market value for all electricity delivered by the Movants pending assumption or rejection of their
20 PPAs and (b) directing the Debtor to pay immediately to the Movants, as an administrative expense
21 under section 503(b) of the Bankruptcy Code, the difference between fair market value and the
22 contract rate for all electricity delivered to PG&E by the Movants from the Petition Date until the
23 granting of relief on the Motions.

24 II.

25 PG&E MUST PAY THE MOVANTS 26 IN ADVANCE FOR THEIR POSTPETITION DELIVERIES OF ELECTRICITY

27 PG&E's bankruptcy does not give it the right to compel QFs to extend credit
28 involuntarily to the Debtor on a postpetition basis without first assuming their PPAs. The

1 Bankruptcy Code provides a debtor with numerous special protections it may offer vendors and
2 potential lenders to induce them to agree to extend credit to the Debtor. The Bankruptcy Code,
3 however, includes no applicable mechanism for forcing a third party such as the Movants to extend
4 credit to the debtor against such party's will. Accordingly, while the Debtor can compel the QFs to
5 deliver electricity on a postpetition basis under the PPAs, it cannot force them to do so without
6 prepaying the QFs for the fair market value of such electricity.

7 The principal policy underlying chapter 11 of the Bankruptcy Code is the promotion
8 of going-concern reorganizations under the theory that going-concern value generally exceeds
9 liquidation value and will thus provide a superior recovery to all constituencies. See United Sav.
10 Ass'n. of Texas v. Timbers of Inwood Forest Assocs. Ltd. (In re Timbers of Inwood Forest
11 Assocs. Ltd.), 808 F.2d 363, 375 (5th Cir. 1987), aff'd, 484 U.S. 365 (1988). Recognizing that
12 access to adequate working capital is paramount to a company's ability to maintain its operations
13 pending reorganization, and recognizing further the natural reticence vendors and lenders may
14 otherwise have in extending credit to a distressed business, Congress armed debtors with an arsenal
15 of tools to encourage or induce third parties to agree to extend credit. At the most basic level,
16 parties who extend postpetition credit to a debtor in the ordinary course of business are afforded
17 administrative priority for their claims, which places their right to repayment ahead of all other
18 unsecured creditors. 11 U.S.C. § 364(a). Section 364 of the Bankruptcy Code then goes on to
19 provide an increasingly tantalizing menu of additional credit incentives such as super-priority
20 administrative claims (11 U.S.C. § 364(c)(1)), senior liens on unencumbered assets (11 U.S.C.
21 § 364(c)(2)), junior liens on encumbered assets (11 U.S.C. § 364(c)(3)), and in certain
22 circumstances, senior liens on encumbered assets (11 U.S.C. § 364(d)(1)). Notably, however,
23 section 364, and indeed the entire Bankruptcy Code, stop short of allowing the debtor to compel a
24 third party to extend credit (subject to two narrow and currently inapplicable exceptions discussed
25 below) - - all of the inducements, incentives and protections are premised on voluntary, agreed-
26 upon extensions of credit. Simply put, Congress has provided no mechanism for the Debtor to
27 compel a QF to extend credit to the Debtor for electricity purchases pending assumption or
28 rejection of the PPAs.

1 There are two instances under the Bankruptcy Code where a debtor may compel a
2 third party to extend credit postpetition: (1) from a utility under section 366 of the Bankruptcy
3 Code; and (2) from a party to an executory contract that includes financial accumulations, but only
4 after the contract is assumed. The first narrow instance arises under section 366 of the Bankruptcy
5 Code, which compels utilities to provide continuous service to a debtor (on credit) for the first 20
6 days after the petition date. Furthermore, if adequate assurance of future payment is provided by
7 the debtor within such 20 day period, the utilities' obligation to extend credit continues. Although
8 section 366(b) requires that the debtor provide protection for the utility's postpetition claim, it
9 nevertheless compels the utility to extend credit when the court, not the utility, determines the
10 protection is appropriate. In recognizing this reality, one court even went so far as to observe that
11 adequate assurance of a utility payment by a debtor does not guarantee the payment, it merely
12 requires that the utility is not subject to "an unreasonable risk of future loss." In re George C. Frye
13 Co., 7 B.R. 856, 858 (Bankr. D. Me. 1980). Of course, this provision was enacted in recognition
14 of the monopoly power enjoyed by utilities and the futility of the reorganization effort if they were
15 left free to "turn out the lights."

16 The second narrow exception to the rule that the Bankruptcy Code does not compel
17 the extension of credit arises where the debtor assumes an executory contract which includes, but is
18 not dominated by, provisions pursuant to which the non-debtor party is to provide financial
19 accommodations to the debtor. The assumption of such an executory contract has the effect of
20 compelling the nondebtor party to perform its obligations under the contract, including those
21 relating to credit extensions, but only after the debtor cures all defaults and provides adequate
22 assurance of future performance. 11 U.S.C. § 365(b)(1). Although section 365(c)(2) explicitly
23 forbids a debtor from assuming an executory contract to provide the debtor "financial
24 accommodations," (Transamerica Commercial Finance Corp. v. Citibank, N.A. (In re Sun Runner
25 Marine, Inc.), 945 F.2d 1089, 1093 (9th Cir. 1991); In re Catapult Entm't, Inc., 165 F.3d 747, 753
26 (9th Cir. 1999)) courts have determined that this prohibition does not apply to contracts which
27 include, but are not dominated by, provisions to provide financial accommodations to the debtor.
28 Citizens and Southern Nat'l Bank v. Thomas B. Hamilton Co., Inc. (In re Thomas B. Hamilton

1 Co., Inc.), 969 F.2d 1013, 1019 (11th Cir. 1992). Thus, a debtor can effectively compel the
2 nondebtor party to extend credit by assuming a contract that contains credit terms. With
3 assumption, however, a debtor must first satisfy critical statutorily imposed obligations before it can
4 reap the benefits: the debtor is required to cure its prepetition defaults and provide adequate
5 assurance of future performance (i.e., demonstrate its wherewithal to fulfill its contractual
6 obligations prospectively). 11 U.S.C. § 365(b).

7 As can thus be seen, Congress has infused the Bankruptcy Code with only two
8 specific provisions that permit a debtor to compel third-parties to extend credit. Neither applies to
9 the present case. Because the Bankruptcy Code is a comprehensive statutory scheme, it must be
10 interpreted according to its plain meaning, as clearly expressing Congress's intent. United States v.
11 Ron Pair Enters., Inc., 489 U.S. 235 (U.S. 1989). Accordingly, in requiring payment in advance,
12 the Movants seek only to limit the Debtor to the rights afforded it under the Bankruptcy Code. If
13 the Debtor wishes to avail itself of the PPAs' credit terms, it must assume the contracts. The
14 Movants cannot be compelled to extend credit to the debtor without first being afforded the
15 statutory protections afforded by section 365(b)(1).

16 Thus, the Court should enter an Order requiring the Debtor to pay in advance for all
17 deliveries of electricity by the Movants pending assumption or rejection of the PPAs (except as may
18 be otherwise agreed by a Movant).

19 III.
20 THE COURT SHOULD REQUIRE PG&E TO
21 ASSUME OR REJECT THE MOVANTS' PPAs BY
JUNE 1, 2001

22 The interim stop-gap solution of compelling the Debtor to pay fair market value in
23 advance for postpetition deliveries of electricity is precisely that: interim. Moreover, such relief will
24 not work for all QFs as it fails to address the needs of QFs that have been severely damaged by the
25 Debtor's prepetition payment defaults. QFs in this category, which include the Movants, need
26 additional redress. They need the Court to order the Debtor promptly to assume or reject their
27 PPAs just to be able to resume and sustain operations. In a recent statement reported on the Dow
28 Jones Newswire, the chairwoman of the California Public Utilities Commission ("CPUC")

1 described the plight of these QFs as follows: "We need to take a hard look at whether utilities pay
2 certain QFs that are on the brink of bankruptcy for back payments. Back payments are a critical
3 part of the mix and are key to preventing some QFs from meeting contractual obligations."

4 In taking a "hard look" at the problems facing the QFs "on the brink of bankruptcy"
5 the Court should maintain its focus on the most important factor in all of this calculus - - the
6 immediate need to bring, and to keep as much electrical generation in California, on-line. For the
7 three QFs at issue, and others like them, the payment of market price in advance may no longer be
8 a viable option. These entities have only one practical option to keep them on-line (and in the case
9 of Oildale and Kingsburg bringing them back on-line for more than the minimal requirements under
10 the PPAs): compel PG&E immediately to assume or reject their contracts. Absent such relief,
11 these projects cannot and will not produce power for the foreseeable future.

12 Section 365 of the Bankruptcy Code provides the Court with the power to compel
13 PG&E to make its decision to assume or reject the PPAs within a specified period of time:

14 In a case under chapter . . . 11 . . . of this title, the trustee may assume or
15 reject an executory contract . . . of the debtor at any time before the
16 confirmation of a plan but the court, on request of any party to such contract
. . . may order the trustee to determine within a specified period of time
whether to assume or reject such contract. . . .

17 11 U.S.C. § 365(d)(2) (emphasis added). In effectuating this provision, the general rule is that a
18 court may, in its discretion, compel the debtor to assume or reject an executory contract within a
19 "reasonable time." Theatre Holding Corp. v. Mauro, 681 F.2d 102, 105 (2d Cir. 1982). In
20 exercising its discretion, a court should consider a number of factors including: "[T]he nature of
21 the interests at stake, the balance of the hurt to the litigants, the good to be achieved, the
22 safeguards afforded those litigants, and whether the action to be taken is so in derogation of
23 Congress' scheme that the court may be said to be arbitrary." Matter of Dunes Casino Hotel, 63
24 B.R. 939, 949 (D. N.J. 1986) (quoting In re GHR Energy Corp., 41 B.R. 668, 676 (Bankr. D.
25 Mass. 1984)).

26 Notably, in assessing a section 365(d) motion, a court must consider not only the
27 debtor's need for "breathing room" but also the non-debtor party's need for certainty and stability.
28 For example, where the non-debtor party's sole source of income is derived from an executory

1 contract with the debtor (as is the case here), courts have compelled the debtor to assume or reject
2 the contract within a shortened period of time. See In re Taber Farm Assocs., 115 B.R. 455
3 (Bankr. S.D.N.Y. 1990). Employing a similar analysis, the court in In re Beker Indus. Corp., 64
4 B.R. 890 (Bankr. S.D.N.Y. 1986), significantly shortened the period in which debtor could decide
5 whether to assume or reject an executory contract. There, the debtor had entered into a series of
6 agreements which required a division of certain fixed and variable costs related to mining
7 operations. In deciding to grant the non-debtor party's motion to compel assumption or rejection
8 of those agreements, the court stated that the non-debtor party "is not expected to incur significant
9 added detriment while those who have an interest in the property or the bankruptcy estate are
10 unable to resolve how to deal with an asset." Id. at 898. The court went on to state that, when the
11 delay between the filing of the petition and the assumption or rejection of an executory contract
12 adds uncertainty and threatens the non-debtor party with additional postpetition costs, sufficient
13 grounds exist for the court to exercise its discretion to compel the debtor to assume or reject the
14 executory contract. In particular, the court indicated that a non-debtor party should not be forced
15 to fund the debtor's bankruptcy. Id. at 899. See also In re Continental Energy Assocs., 178 B.R.
16 at 408 (court protected non-debtor party's constitutional rights by compelling assumption or
17 rejection within thirty days).

18 Under the foregoing authorities, it is clear that a debtor's "breathing room" is not
19 inviolate and can, under appropriate circumstances, give way to concerns regarding the non-debtor
20 party. It is difficult to conceive of a situation in which the non-debtor party's need for an
21 immediate assumption or rejection is more compelling than that of the QFs here. Oildale and
22 Kingsburg are currently not generating electricity. Wadham may be off-line soon. Significantly,
23 the PPAs basically represent the sole source of income for these projects. To the extent that the
24 Court refuses to condition the Movants' future performance on prepayments at market rates or to
25 excuse the Movants' performance under the PPAs, there is no feasible way for the Debtor to afford
26 the luxury of deliberations extending over weeks, much less months or years. PG&E needs to
27 decide now whether it wants to assume or reject the PPAs and, to that end, the Court should enter
28

1 an Order requiring the Debtor to obtain an order approving assumption of the Movants' PPAs by
2 June 1, 2001 or else the PPAs will be deemed rejected.

3
4 IV.

5 ALTERNATIVELY, THE COURT SHOULD LIFT THE AUTOMATIC
6 STAY FOR "CAUSE" TO PERMIT
7 THE MOVANTS TO SUSPEND THEIR PPAs PENDING
8 ASSUMPTION OR REJECTION AND CONDUCT THIRD-PARTY
9 SALES DURING THAT SAME TIME PERIOD

10 Section 362(d) of the Bankruptcy Code provides as follows:

11 On request of a party in interest and after notice and a hearing, the Court
12 shall grant relief from the stay provided under subsection (a) of this
13 section, such as by terminating, annulling, modifying, or conditioning such
14 stay... (1) for cause, including the lack of adequate protection of an
15 interest in property of such party in interest...

16 11 U.S.C. § 362. A bankruptcy court is thus mandated to lift or modify the automatic stay imposed
17 by section 362(a) of the Bankruptcy Code if "cause" is shown. "Cause" is not defined in the
18 Bankruptcy Code and in fact is determined on a fact-intensive case-by-case basis. See Benedor
19 Corp. v. Conejo Enters., Inc. (In re Conejo Enters., Inc.), 96 F.3d 346, 352 (9th Cir. 1996); Tuscon
20 Estates, Inc. v. Christensen (In re Tucson Estates, Inc.), 912 F.2d 1162, 1166 (9th Cir. 1990).
21 Furthermore, bankruptcy courts have broad discretion in making the factual determination of what
22 constitutes cause to lift the stay, since a motion for relief from stay gives rise to a summary
23 proceeding. See Computer Communications, Inc. v. Codex Corp. (In re Computer
24 Communications, Inc.), 824 F.2d 725, 729 (9th Cir. 1987). In summary proceedings, a court's
25 discretion is broadly construed. Packerland Packaging Co., Inc. v. Griffith Brokerage Co. (In re
26 Kemble), 776 F.2d 802, 807 (9th Cir. 1985).

27 In respect of the present Motions for relief from stay, it is important to note that the
28 Movants are not seeking to terminate the PPAs pursuant to applicable California state law, but
rather only to suspend their performance with PG&E pending assumption or rejection. In other

1 words, the Movants seek the right to suspend postpetition performance and enter into third-party
2 sales, while preserving fully the Debtor's right to later assume or reject the PPAs.⁴

3 In determining whether such relief is warranted, the Court should focus most closely
4 on two factors: (i) the debtor's inability and/or unwillingness to provide assurances for the
5 payment of postpetition administrative claims and (ii) the inherent hardships occasioned by the
6 magnitude of the Debtor's defaults under the PPAs, in both cases, balanced with the overall goals
7 of the Bankruptcy Code. See In re Opelika Mfg. Corp., 66 B.R. 444, 449 (Bankr. N.D. Ill. 1986)
8 (citations omitted). In the present case, the balance of hardships engendered by the Debtor's failure
9 to make past payments clearly favors granting the Movants relief. There can be no dispute here
10 that, in an attempt to stockpile money prepetition, PG&E ran up massive prepetition debts to QFs,
11 forcing the Movants to the edge of financial ruin. With some QFs already off-line and others close
12 to shutting down, the capacity for electricity generation in the State has decreased significantly.
13 Should the Court, however, enter a finding of cause and lift the automatic stay, these QFs may be
14 able to sell power on the open market and, through that income stream, secure financing to keep
15 their operations running. Moreover, the Court should not ignore the "ripple effect" that will occur
16 if relief is not granted to the Movants. As noted above, Oildale's thermal host has filed its own
17 chapter 11 petition, purportedly in large part due to its inability to obtain thermal energy from
18 Oildale. More to the point, should those QFs on the brink file their own chapter 11 petitions,
19 rejection of the PPA in their own bankruptcies would be an immediate option, thereby taking away
20 the possibility that PG&E will ever be able to assume the PPAs in question.

21
22 ⁴ Under existing Ninth Circuit precedent it is unclear whether the automatic stay even prevents
23 suspension of executory contracts as they are generally not considered "property of the estate"
24 unless and until they are assumed. See Otto Preminger Films, Ltd. v. Qintex Entm't, Inc. (In
25 re Qintex Entertainment, Inc.), 950 F.2d 1492, 1495 (9th Cir. 1991) ("An executory contract
26 does not become an asset of the estate until it is assumed pursuant to § 365 of the Code.");
27 Chbat v. Tleel (In re Tleel), 876 F.2d 769, 770 (9th Cir. 1989) ("Unless and until rights under
28 an executory contract are timely and affirmatively assumed by the trustee, they do not become
property of the debtor's estate"); Cheadle v. Appleatchee Riders Ass'n (In re Lovitt), 757 F.2d
1035, 1041 (9th Cir. 1985) ("[E]xecutory contracts ... do not vest in the trustee as of the date
of the filing of the bankruptcy petition. They vest only upon the trustee's timely and
affirmative act of assumption A bankruptcy court has no jurisdiction over assets outside of
the bankrupt's estate...").

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V.

CONCLUSION

For the foregoing reasons, the Movants respectfully request that this Court enter an order (i) directing PG&E to pay the Movants in cash in advance for all postpetition deliveries pursuant to the PPAs, at rates that are equivalent to the fair market value of the electricity delivered, and (ii) requiring PG&E to obtain an order approving assumption of the PPAs by June 1, 2001 or have the PPAs deemed rejected; or, alternatively, (iii) lifting the automatic stay to allow the Movants to suspend performance under the PPAs and make deliveries to third-party purchasers, and (iv) granting such other and further relief as the Court deems just.

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