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PACIFIC GAS AND ELECTRIC COMPANY

UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF CALIFORNIA

In re

PACIFIC GAS AND ELECTRIC
COMPANY, a California corporation,

Debtor.

No. 01-30923 DM

Chapter 11 Case

Date: February 8, 2002

Time: 2:30 p.m.

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

Federal I.D. No. 94-0742640

DEBTOR'S NOTICE OF MOTION AND MOTION FOR ORDER APPROVING
EXPENDITURE OF FUNDS TO UPGRADE SUBSTATIONS AND, IF NECESSARY,
RECONDUCTOR A 230 KV TRANSMISSION LINE TO SUPPORT THE LOS BANOS-
GATES 500 KV TRANSMISSION PROJECT (PATH 15 UPGRADE PROJECT);
SUPPORTING MEMORANDUM OF POINTS AND AUTHORITIES

[SUPPORTING DECLARATIONS OF KEVIN DASSO AND VALERIE O. FONG
FILED SEPARATELY]

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HOWARD
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MEMORANDUM OF POINTS AND AUTHORITIES

I. INTRODUCTION

By this Motion, Pacific Gas and Electric Company, the debtor and debtor in possession in this Chapter 11 case ("PG&E" or the "Debtor"), seeks an order pursuant to Sections 363 and 105 of the Bankruptcy Code (11 U.S.C. §§363 & 105)¹ authorizing PG&E to enter into binding agreements to expend the funds necessary to design and build 500 kV and 230 kV substation equipment, and, if needed, to reconductor 230 kV transmission lines, to accommodate a new 500 kV transmission line to be constructed by the Western Area Power Administration ("WAPA"). PG&E estimates that this work, and previously incurred engineering and permitting costs, will not exceed \$75 million.

Path 15 is a series of high-capacity transmission lines that connect customers in Northern and Southern California and also forms part of the Pacific AC Intertie linking the Pacific Northwest and Oregon to Southern California. The Path 15 Upgrade Project will increase the south-to-north rating of Path 15 by approximately 1500 megawatts ("MW") through the addition of a new 500 kV line between PG&E's Los Banos and Gates substations. WAPA will construct the 500 kV line portion of the Path 15 Upgrade Project with funding from other project participants. The purpose of the Path 15 Upgrade Project is to decrease congestion on Path 15.

Following congestion on Path 15 during various periods in 2000 and before PG&E's Chapter 11 filing, the California Public Utilities Commission ("CPUC") ordered PG&E to submit an application for a Certificate of Public Convenience and Necessity (a "CPCN") to construct the Path 15 Upgrade Project. PG&E submitted a Conditional Application to the CPUC on April 13, 2001 pursuant to the CPUC order and applicable provisions of the California Public Utilities Code.² While that CPCN application was

¹Unless otherwise indicated, all statutory references in this Motion are to the United States Bankruptcy Code (Title 11 of the United States Code).

²See Cal. Pub. Util. Code §1001 et seq., Rules 2-8, 15, 16, 17.1, 17.3 and 18 of the CPUC Rules of Practice and Procedure (Cal. C. of Regs., Title 20), CPUC General Order 131-D.

1 pending, the United States Department of Energy directed WAPA to solicit expressions of
2 interest in constructing the Path 15 Upgrade Project, and WAPA did so through a Federal
3 Register Notice. On October 16, 2001, PG&E, WAPA and other participants executed a
4 non-binding Memorandum of Understanding ("MOU") regarding construction of the Path 15
5 Upgrade Project. WAPA, PG&E and the other participants are now in the process of
6 negotiating binding agreements regarding construction of the Path 15 Upgrade Project.

7 On November 6, 2001, in light of the MOU, PG&E filed a "Notice of
8 Withdrawal" of its Conditional Application. In an order dated November 30, 2001 (the
9 "CPUC Order"), the CPUC treated PG&E's notice as a motion for permission to withdraw
10 the conditional application, denied it, and consolidated the conditional application with the
11 CPUC's investigation, pursuant to California Assembly Bill 970, of electric transmission
12 and distribution constraints, actions to resolve those constraints, and related matters affecting
13 the reliability of electric supply.³ The CPUC's Administrative Law Judge has scheduled
14 hearings on the economic benefit of the Path 15 Upgrade Project, required submission of the
15 MOU implementation agreements to be followed by hearings thereon, and ordered briefing
16 on whether a CPCN is required for PG&E's participation in the project.⁴

17 Because the WAPA-sponsored Path 15 Upgrade Project will increase the Path 15
18 electric transmission capacity to the same extent as contemplated in PG&E's Conditional
19 Application, allow PG&E to obtain a share of such capacity commensurate with its costs
20 incurred for the benefit of the Path 15 Upgrade Project, and require PG&E to incur costs
21 estimated at or less than \$75 million, rather than spend the estimated \$325 million it will
22 cost to construct the entire Path 15 Upgrade Project, PG&E intends to participate in the

23 ³See CPUC Investigation No. 00-11-001. A true and correct copy of the CPUC Order
24 is attached as Exhibit B to the Declaration of Kevin Dasso (hereinafter referred to as the
"Dasso Declaration" and cited as the "Dasso Decl.") filed concurrently herewith.

25 ⁴Although the Office of Ratepayer Advocates ("ORA") asserts that PG&E must have a
26 CPCN to construct its contemplated portion of the Path 15 Upgrade Project, PG&E believes
27 that, based on unambiguous language in General Order 131-D, it does not need a CPCN to
28 perform the work that it would commit to perform in support of the Path 15 Upgrade Project.
If the CPUC finds otherwise, PG&E will determine whether it wishes to participate in the
WAPA-sponsored project at that time.

1 Path 15 Upgrade Project through its contemplated work in support of the WAPA-sponsored
2 project rather than pursuing its Conditional Application to construct the entire project alone.

3 PG&E brings this Motion because the requested \$75 million exceeds the project
4 limit authorized in PG&E's Motion for Authority to Make Capital Expenditures in the
5 Ordinary Course of Business filed in this case on June 6, 2001, which was approved
6 pursuant to the Court's Order thereon dated June 29, 2001 (such prior Motion and Order
7 hereinafter are collectively referred to as the "Omnibus Cap Ex Motion and Order"). In
8 broad outline, pursuant to the Omnibus Cap Ex Motion and Order, PG&E is authorized to
9 proceed (a) without notice to or approval of the Court or the Official Committee of
10 Unsecured Creditors (the "Committee"), with any project costing less than \$10 million,
11 (b) with notice to and no objection by the Committee, with any project costing more than
12 \$10 million and less than \$50 million, and (c) only upon a motion noticed to the Committee
13 and the United States Trustee on at least 10 business days' notice and approval of the Court,
14 with any project anticipated to cost more than \$50 million.

15 PG&E submitted a notice and description of the Path 15 Upgrade Project to the
16 Committee on November 29, 2001. The Committee on December 12, 2001 indicated in
17 writing that it had no objection to the Debtor proceeding with the Path 15 Upgrade Project.
18 PG&E respectfully requests that the Motion be granted and that PG&E be authorized to
19 enter into binding agreements to expend up to \$75 million for its work in support of the
20 Path 15 Upgrade Project.

II.

FACTUAL BACKGROUND⁵

A. The Path 15 Upgrade Project.

The transmission system segment known as Path 15 is located in the southern portion of the PG&E service area and in the middle of the Independent System Operator ("ISO") Control Area.⁶ This path consists of the following lines:

Los Banos-Gates 500 kV

Los Banos-Midway 500 kV

Gates-Panoche #1 230 kV

Gates-Panoche #2 230 kV

Gates-Gregg 230 kV

Gates-McCall 230 kV

These facilities are used to meet transmission capacity requirements of various parties in the Northwest, Northern California and Southern California, and for integrating generating plants within the ISO-controlled grid. Fong Decl. Ex. A at 7 (BKCC 00748)

The Path 15 Upgrade Project has been designed to increase transmission capacity and to further integrate generating plants within the ISO-controlled grid. As part of the Path 15 Upgrade Project contemplated by the MOU, certain upgrades of PG&E's existing 500 kV and 230 kV substation equipment and, if needed, reconductoring of PG&E's existing 230 kV transmission lines are necessary to accommodate the additional 500 kV transmission lines to be constructed by WAPA. As part of the Path 15 Upgrade Project, PG&E will design and construct the following facilities:

⁵The evidentiary basis and support for the facts set forth in this Motion are contained in the Dasso Declaration and in the Declaration of Valerie Fong (hereinafter referred to as the "Fong Declaration" and cited as the "Fong Decl."), both filed concurrently herewith. Where there is no citation supporting a particular fact, the evidentiary basis for such fact is contained in the Dasso Declaration. Where, on the other hand, the evidentiary basis for a particular fact is contained in the Fong Declaration, we will specifically cite to the Fong Declaration.

⁶See Fong Decl., Ex. A.

- 500 kV terminal equipment at Los Banos and Gates for the proposed Los Banos-Gates 500 kV transmission line;
- Reconfiguration of the Gates 500 kV bus from a ring-bus to a breaker-and-a-half arrangement;
- Install 250 MVAR of 230 kV shunt capacitors at both Los Banos and Gates substations to provide necessary voltage support; and
- Reconductor the Gates-Midway 230 kV transmission line or provide the necessary capability by re-rating the transmission lines. (The recommended expenditure includes the more costly reconductoring option). Fong Decl. Ex. A at 10 (BKCC 00751)

Path 15 is currently constrained to a lower south-to-north transfer limit than the rest of the 500 kV system in Northern California because there are just two 500 kV lines in this area. Additionally, because the two 500 kV lines are located in a common corridor, the Western Systems Coordinating Council ("WSCC") transmission reliability criteria require that the system be operated to withstand their simultaneous loss ("Los Banos South double-line outage"). Under these criteria, the present maximum south-to-north transfer limit is 3,950 MW. This limit is based on the availability of special automatic and manual operating procedures that would be initiated immediately after any Los Banos South double line outage. Id. at 7-8 (BKCC 00748-00749)

The ISO has found in recent years that Path 15 congestion has resulted in higher generating costs to Northern California consumers mainly during off-peak periods. During such periods, the ISO has found that it has been necessary to operate higher-cost generation in Northern California, to import higher-cost power from the Northwest, or to reroute lower-cost power from Southern California onto the Pacific DC Intertie to meet demand in Northern California. The ISO has found that access to additional lower-cost generating resources in the south has been limited due to the Path 15 transfer limits. Id. at 8 (BKCC 00749).

Due to limited generation availability in Northern California during the latter part

1 of 2000, congestion on Path 15 began to occur much more frequently. The problem
2 escalated further in January 2001 as a shortage of generation in Northern California led to
3 rotating outages north of Path 15. While the ISO concluded that there were additional
4 generating reserves in Southern California, the ISO found that constraints on Path 15
5 prevented full access to this generation. The ISO further found that Path 15 constraints,
6 combined with generation shortages, could again contribute to rotating outages in Northern
7 California. Fong Decl. Ex. A at 8 (BKCC 00749).

8 PG&E and the ISO began analysis of Path 15, even before the rotating outages
9 occurred, with the objective of identifying alternatives to reduce off-peak generation costs.
10 Subsequent analyses conducted by the ISO following the outages described above indicated
11 that: (1) Path 15 congestion resulted in increased market costs ranging from \$7 million to
12 \$220 million over the 16-month period ending December 31, 2000 (depending on how the
13 market would have responded had the Path 15 upgrade been in-service); and (2) Path 15
14 constraints could contribute to future rotating outages. Although these analyses were not
15 conclusive on project need, there was sufficient support to begin the work necessary to
16 undertake the permitting process so that, if further analyses showed the project was needed,
17 the potential project could be in operation as soon as possible. Id.

18 Therefore, subject to PG&E management's approval, PG&E requested ISO
19 approval to conduct preliminary engineering and project siting work necessary to pursue the
20 permits for the construction of a new Los Banos-Gates 500 kV project. The ISO approved
21 PG&E's request to proceed with the permitting process on February 5, 2001. Additionally,
22 before applying for the necessary permits, the PG&E and ISO agreed to perform additional
23 analyses to ascertain project need under future generation build-out scenarios. Id.

24 Thereafter, the development of a Path 15 upgrade project progressed on two
25 parallel tracks—PG&E sponsorship and WAPA sponsorship.

26
27 1. PG&E-Sponsorship Track.

28 On March 29, 2001, the CPUC ordered PG&E to submit an application for a

1 CPCN to construct the Path 15 Upgrade Project. Pursuant to the CPUC order, PG&E
2 submitted a Conditional Application to the CPUC on April 13, 2001 for a CPCN authorizing
3 the construction of the Path 15 Upgrade Project. PG&E's application was conditioned upon
4 the following: (1) a PG&E and ISO determination that the Project is needed and cost
5 effective; (2) PG&E management approval; and (3) this Court's approval of the expenditure
6 of funds to construct the Path 15 Upgrade Project. Fong Decl. Ex. A at 9 (BKCC 00750).

7 PG&E and the ISO submitted opening testimony in the CPCN proceeding on
8 September 25, 2001 regarding the conditional application. PG&E's testimony presented,
9 among other things, two service alternatives considered for upgrading Path 15, the estimated
10 cost of those alternatives, possible routes for the new line, and the estimated cost of those
11 route alternatives. The ISO's testimony addressed the economic need for the Path 15
12 Upgrade Project, and concluded that the Path 15 Upgrade Project is cost-justified. The ORA
13 submitted opposing testimony and the ISO submitted rebuttal testimony. No CPUC
14 administrative hearings were or have been held on the Path 15 Upgrade Project. Id.

15 As set forth below, while PG&E's Conditional Application was pending before
16 the CPUC, the United States Department of Energy and WAPA solicited interest in a public-
17 private partnership to construct the Path 15 Upgrade Project. Following execution of the
18 MOU regarding the WAPA-sponsored Path 15 Upgrade Project, PG&E withdrew its
19 Conditional Application on November 6, 2001 and its opening testimony on November 13,
20 2001. Although the CPUC declined to allow PG&E to withdraw its Conditional
21 Application, it dropped scheduled hearings on the PG&E-sponsored Path 15 Upgrade Project
22 and consolidated the Conditional Application proceeding with the CPUC's ongoing
23 investigation pursuant to California Assembly Bill 970 of electric transmission and
24 distribution constraints. Thereafter, the CPUC's Administrative Law Judge set hearings in
25 late February 2002 to consider the economic need for the Path 15 Upgrade Project, required
26 PG&E to submit the MOU implementation agreements, and scheduled briefing on the
27 ORA's claim that PG&E needed a CPCN to perform its contemplated portion of the WAPA-
28 sponsored Path 15 Upgrade Project.

There is no CPUC order directing PG&E to construct the entire Path 15 Upgrade Project, forbidding PG&E from participating in the WAPA-sponsored Path 15 Upgrade Project, or requiring PG&E to obtain a CPCN to participate in the WAPA-sponsored Path 15 Upgrade Project as contemplated by the MOU.⁷

2. WAPA-Sponsorship Track.

In May 2001, the United States Secretary of Energy, prompted by a Presidential directive incorporated in the National Energy Policy report, directed WAPA to complete planning for an upgrade to Path 15 and to solicit financing and ownership interest in the project. In June 2001, WAPA posted a notice in the Federal Register to solicit financing and ownership interest in a project to upgrade Path 15 based on the proposed Path 15 Upgrade Project set forth in PG&E's Conditional Application. Following its solicitation, WAPA met with a number of public and private entities to discuss the possibility of constructing the Path 15 Upgrade Project. Fong Decl. Ex. A at 9 (BKCC 00750).

These discussions led to the development of a non-binding MOU executed on October 16, 2001.⁸ The MOU outlines, on a preliminary basis, the responsibilities, financial contributions, ownership rights and operational details of the Project and requires the parties to agree on “an aggressive schedule to define the Project and the work to be done at each facility” by January 16, 2002. Dasso Decl. Ex. A at 6. The MOU contemplates that the increased transmission capacity arising from the Path 15 Upgrade Project will be shared among the public and private entities commensurate with each entity’s contributions to the Path 15 Upgrade Project. PG&E’s proposed contributions would include:

- (1) environmental and engineering studies and design work performed to date; and
- (2) detailed design and construction work for the 500 kV and 230 kV substation and 230 kV

⁷ Should any such order issue, PG&E will evaluate its effect on PG&E's planned participation in the Path 15 Upgrade Project and return to this Court for further approvals of expenditures as necessary.

⁸A true and correct copy of the MOU is attached as Exhibit A to the Dasso Declaration.

1 reconductoring work necessary to accommodate the additional 500 kV transmission lines to
2 be constructed by WAPA, which PG&E believes will be consistent with PG&E's Plan of
3 Service Alternative 2 outlined in its since-withdrawn opening testimony submitted in the
4 CPUC Conditional Application proceeding. The total cost for this work is estimated not to
5 exceed \$75 million. Based on the ratio of PG&E's contribution to the anticipated total
6 project cost (\$325 million, although certain aspects of the project may change under WAPA-
7 sponsorship), PG&E would be allocated about 345 MW of the 1500 MW incremental
8 transfer capability. Fong Decl. Ex. A at 10 (BKCC 00751).

9 PG&E's design and construction of the substation modifications is contingent
10 upon enabling agreements for the Path 15 Upgrade Project being developed and executed.
11

12 **B. Expected Cost Of PG&E's Contemplated Work.**

13 On December 19, 2001, PG&E's Board of Directors approved a capital
14 expenditure of \$75 million for PG&E's work in support of the Path 15 Upgrade Project.⁹
15 These funds are expected to cover PG&E's anticipated work supporting the Path 15 Upgrade
16 Project and the work which, with Bankruptcy Court approval, PG&E intends to commit to
17 perform in binding agreements for the Path 15 Upgrade Project.

18 Based on preliminary design estimates prepared for the Conditional Application
19 Project, Alternative 2, Western Corridor Route, and including previously-incurred
20 engineering and permitting costs, PG&E estimates that its work in support of the WAPA-
21 sponsored Path 15 Upgrade Project will cost approximately \$75 million, with \$4 million to
22 be included in the 2002 budget and the balance presently anticipated to be incurred in the
23 next few years consistent with the Path 15 Upgrade Project's current targeted completion
24 date in 2004.

25 The cost of PG&E's work in support of the Path 15 Upgrade Project is expected

26
27 ⁹The \$75 million includes \$9.5 million previously approved by the Board of Directors
28 on May 8, 2001 for environmental, engineering and permitting work related to the Path 15
Upgrade Project.

1 to be included in PG&E's base revenue requirement to be recovered through the FERC Rate
2 Case, earning the authorized return established in that proceeding. The Path 15 Upgrade
3 Project participants were advised by FERC staff that the Path 15 Upgrade Project may be
4 eligible for pre-construction approval, accelerated depreciation, and a 200 basis points
5 premium on return on equity. PG&E's contribution of approximately \$75 million in work to
6 support the Path 15 Upgrade Project translates to an increase in PG&E's present value of
7 revenue requirement of \$95 million based on standard depreciation and return on equity.
8 Fong Decl. Ex. A at 10 (BKCC 00751).

9
10 III.

11 THE PATH 15 UPGRADE PROJECT SHOULD BE AUTHORIZED
12 PURSUANT TO SECTIONS 363 AND 105 OF THE
BANKRUPTCY CODE

13 As set forth at some length in the Omnibus Cap Ex Motion, PG&E on an annual
14 basis makes approximately \$1.5 billion in capital expenditures in the ordinary course of its
15 business of providing gas and electric service to its customers. These capital expenditures
16 cut across the utility functions of the company (including electric distribution, gas
17 distribution, electric transmission, gas transmission and electric generation) and generally
18 fall into one or more of three broad categories: (1) emergency/safety projects; (2) projects
19 that are mandated by regulatory or legal orders (including projects undertaken to remain in
20 compliance with regulatory and legal requirements); and (3) other projects, such as projects
21 designed to improve the reliability of PG&E's distribution or transmission system which
22 may not be mandated by specific performance requirements. See Omnibus Cap Ex Motion
23 at 3:19-4:4.

24 The Path 15 Upgrade Project has elements of all three expenditure categories, in
25 that the completion of the Project may help avoid emergency shortages in Northern
26 California and the Project was designed in response to regulatory directives.

27 As previously noted in the Cap Ex Omnibux Motion, PG&E believes that the
28 expenditures on virtually all of its capital projects as described above are within the ordinary

1 course of its business. As such, PG&E appreciates that such expenditures should be
2 permitted without notice or hearing or any Bankruptcy Court approval pursuant to 11 U.S.C.
3 Section 363(c) as a use, sale or lease of estate property in the ordinary course of business.
4 However, recognizing that few are the cases in which a debtor in possession must make well
5 over \$1 billion in capital expenditures per year due to the unique nature of its business and
6 the complex regulatory environment in which it operates, PG&E already has agreed that the
7 Committee and the Court should be apprised of and/or asked to approve PG&E's capital
8 expenditures at certain substantial materiality thresholds as established in the Omnibus Cap
9 Ex Motion and Order. See generally Omnibus Cap Ex Motion at 15:23-16:20. Thus,
10 although the Path 15 Upgrade Project will be undertaken in the ordinary course of PG&E's
11 business, PG&E seeks this Court's authority to proceed with the Path 15 Upgrade Project
12 because the anticipated cost of the Project exceeds \$50 million, and a motion and Court
13 approval therefore are required pursuant to the Omnibus Cap Ex Motion and Order.

14 PG&E has demonstrated in Part II above that the Path 15 Upgrade Project is
15 perceived to be an important one by PG&E's regulators, and that the proposed maximum
16 \$75 million expenditure for such Project pursuant to the Motion will attain the
17 implementation and completion of the Project at a materially reduced overall cost to the
18 Debtor and its ratepayers. Accordingly, this Court plainly can and should utilize its
19 authority under Section 363 of the Bankruptcy Code to approve the capital expenditure
20 authorization for PG&E's work in support of the Path 15 Upgrade Project as requested by
21 the Motion.

22 Additionally, Section 105(a) of the Bankruptcy Code authorizes this Court to
23 "issue any order, process, or judgment that is necessary or appropriate to carry out the
24 provisions of this title." The purpose of Section 105 is "to assure the bankruptcy courts'
25 power to take whatever action is appropriate or necessary in aid of the exercise of their
26 jurisdiction." 2 Lawrence P. King Collier on Bankruptcy ¶105.01 at 105-6 (15th ed. rev.
27 2000). For the reasons set forth above, the capital expenditure authorization for PG&E's
28 work in support of the Path 15 Upgrade Project requested by the Motion plainly will best

1 serve the interests of the Debtor, its creditors and its customers alike, and will not violate any
2 principle or precept of the Bankruptcy Code. Accordingly, pursuant to the Court's authority
3 and discretion under Section 105(a) of the Bankruptcy Code, the Court can and should grant
4 the Motion.

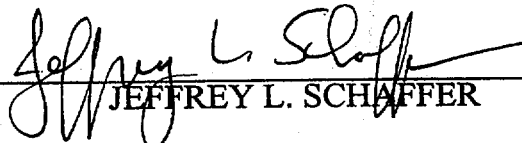
5
6 CONCLUSION

7 For all of the foregoing reasons, PG&E respectfully requests that this Court make
8 and enter an order granting the Motion, thus authorizing PG&E to enter into contractual
9 commitments for, and incur the expenditure of funds up to, a maximum of \$75 million for
10 PG&E's work in support of the Path 15 Upgrade Project pursuant to the MOU.

11 DATED: January 24, 2002

12 Respectfully submitted,

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

15 By: 
JEFFREY L. SCHAFER

16 Attorneys for Debtor and Debtor in Possession
17 PACIFIC GAS AND ELECTRIC COMPANY
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