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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 CONSTRUCT THE TRI-VALLEY
PROJECT; SUPPORTING MEMORANDUM OF POINTS AND AUTHORITIES

[SUPPORTING DECLARATIONS OF GARRETT TIMOTHY GRIDER AND
VALERIE O. FONG FILED SEPARATELY]

Acc: Add: Rick's Age Mail Center

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NOTICE OF MOTION AND MOTION

PLEASE TAKE NOTICE that on February 8, 2002, at 2:30 p.m., or as soon thereafter as the matter may be heard, in the Courtroom of the Honorable Dennis Montali, located at 235 Pine Street, 22nd Floor, San Francisco, California, Pacific Gas and Electric Company, the debtor and debtor in possession in the above-captioned Chapter 11 case ("PG&E" or the "Debtor"), will and hereby does move the Court (the "Motion") for entry of an order authorizing PG&E to construct and energize the project known as the Tri-Valley Electrical Capacity Project ("Tri-Valley Project") as more particularly described in the accompanying Memorandum of Points and Authorities incorporated by reference herein.

This Motion is made pursuant to Sections 105 and 363 of the United States Bankruptcy Code (11 U.S.C. §§105 & 363) and is based on the facts and law set forth in the attached Memorandum of Points and Authorities, the Declarations of Garrett Timothy Grider and Valerie O. Fong filed concurrently herewith, the record of this case and any evidence presented at or prior to the hearing on this Motion.

PLEASE TAKE FURTHER NOTICE that this Motion is being noticed for hearing on ten (10) business days' notice pursuant to the above-captioned Court's Order Re Motion For Authority To Make Capital Expenditures In The Ordinary Course of Business dated June 29, 2001 (the "Cap Ex Omnibus Order"). The Cap Ex Omnibus Order does not specify the time for filing any written opposition to the Motion; nonetheless, because both the Court and PG&E should have the opportunity to review any written opposition to this Motion prior to the hearing thereon, parties in interest are advised to file any written opposition to the Motion and the relief requested therein with the Bankruptcy Court no later than two business days prior to the hearing, and to serve any such written opposition upon counsel for PG&E, the Office of the United States Trustee, and the Official Committee of Unsecured Creditors by hand service on the same date. If there is no timely objection to the requested relief, the Court may enter an order granting such relief without further hearing.

1 MEMORANDUM OF POINTS AND AUTHORITIES

2
3 I. INTRODUCTION

4 By this Motion, Pacific Gas and Electric Company, the debtor and debtor in
5 possession in this Chapter 11 case ("PG&E" or the "Debtor"), seeks an order pursuant to
6 Sections 363 and 105 of the Bankruptcy Code (11 U.S.C. §§363 & 105)¹ authorizing the
7 construction of the Tri-Valley Project. The purpose of the Tri-Valley Project is to build
8 electric transmission and distribution facilities to meet the projected electric demand in the
9 cities of Dublin, Livermore, Pleasanton, and San Ramon, and in portions of unincorporated
10 Alameda and Contra Costa Counties near these cities (collectively the "Tri-Valley area").

11 PG&E brings this Motion because the requested \$135.9 million expenditure
12 authorization exceeds the project limit authorized in PG&E's Motion for Authority to Make
13 Capital Expenditures in the Ordinary Course of Business filed in this case on June 6, 2001,
14 which was approved pursuant to the Court's Order thereon dated June 29, 2001 (such prior
15 Motion and Order hereinafter are collectively referred to as the "Omnibus Cap Ex Motion
16 and Order"). In broad outline, pursuant to the Omnibus Cap Ex Motion and Order, PG&E is
17 authorized to proceed (a) without notice to or approval of the Court or the Official
18 Committee of Unsecured Creditors (the "Committee"), with any project costing less than
19 \$10 million, (b) with notice to and no objection by the Committee, with any project costing
20 more than \$10 million and less than \$50 million, and (c) only upon a motion noticed to the
21 Committee and the United States Trustee on at least 10 business days' notice and approval
22 of the Court, with any project anticipated to cost more than \$50 million.

23 PG&E submitted a notice and description of the Tri-Valley Project to the
24 Committee on November 29, 2001, which the Committee approved on December 12, 2001.
25 The Committee on December 12, 2001 indicated in writing that it had no objection to the
26 Debtor proceeding with the Tri-Valley Project.

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

1 Before PG&E's Chapter 11 filing, PG&E applied to the California Public
2 Utilities Commission ("CPUC") pursuant to applicable provisions of the California Public
3 Utilities Code² for a Certificate of Public Convenience and Necessity (a "CPCN") to
4 construct the Tri-Valley Project. In a final order dated October 10, 2001 (the "CPUC
5 Order"), the CPUC approved the Project and, subject to PG&E's acceptance of the
6 conditions in the CPUC Order, issued PG&E a CPCN.³ As discussed further below, the
7 CPUC Order purports to set a "cost cap" on the Tri-Valley Project in the amount of
8 \$118,359,015 (approximately \$17 million less than PG&E currently estimates the Project
9 will cost to build). Notwithstanding the CPUC's "cost cap," PG&E requests that the
10 Motion be granted and that PG&E be authorized to construct and install the Tri-Valley
11 Project and to expend up to \$135.9 million for its construction and installation of the Project.
12 PG&E further requests that it receive such approval forthwith because the Tri-Valley Project
13 already is behind schedule.

14 II. FACTUAL BACKGROUND⁴

15 A. The Tri-Valley Project

16 Due to the extension of mass transportation, favorable land costs and availability,
17 and relative proximity to the greater Bay Area, the Tri-Valley area is experiencing rapid
18 development. Several major residential and commercial developments currently are in the
19 planning, approval or construction phases, and electric load in the area is expected to double
20 over the next 15 to 20 years, growing at a rate of 27 megawatts ("MW") per year. To

21 ² See Cal. Pub. Util. Code §1001 et seq.; CPUC Rules of Practice and Procedure 2-8,
22 15, 16, 17.1, 17.3, 18 (Cal. Code of Regs., Title 20); CPUC General Order 131-D.

23 ³ A true and correct copy of the CPUC Order is attached as Exhibit A to the
24 Declaration of Garrett Timothy Grider (hereinafter referred to as the "Grider Declaration"
25 and cited as the "Grider Decl.") filed concurrently herewith.

26 ⁴ The evidentiary basis and support for the facts set forth in this Motion are contained in
27 the Grider Declaration and in the Declaration of Valerie O. Fong (hereinafter referred to as
28 the "Fong Declaration" and cited as the "Fong Decl.") filed concurrently herewith. Where
there is no citation supporting a particular fact, the evidentiary basis for such fact is
contained in the Grider 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.

1 support the load growth, the California Independent System Operator ("ISO") has found, and
2 the CPUC has agreed, that substantial additions to PG&E's transmission and distribution
3 systems will be required to be in place by summer 2003 and 2004 to meet demand and
4 ensure system reliability.⁵

5 The Tri-Valley Project, composed of a Northern and Southern Component, has
6 been designed to solve transmission and distribution deficiencies in the Tri-Valley area. To
7 complete the Northern Component of the Tri-Valley Project, PG&E will:

- 8 • Construct two new 230/21 kilovolt ("kV") distribution substations, one in
9 North Livermore and the other in North Dublin, along with the necessary
10 distribution circuits; and
- 11 • Construct approximately 8.2 miles of 230 kV double circuit transmission
12 line (5.4 miles of underground and 2.8 miles of overhead) from the Contra
13 Costa-Newark No. 2 circuit to the new distribution substations.

14 To complete the Southern Component of the Tri-Valley Project, PG&E will:

- 15 • Convert the Vineyard substation from 60 kV to 230 kV service along with
16 constructing the necessary distribution circuits; and
- 17 • Construct 5.7 miles of 230 kV underground double circuit transmission
18 line from the Contra Costa-Newark No. 2 230 kV circuit to Vineyard
19 substation.

20 PG&E originally scheduled construction on the Tri-Valley Project to begin in
21 June 2001 so that the Project would become operational in June 2002. Because of delays in
22 the CPUC proceedings, the Tri-Valley Project currently is behind schedule. To meet the
23 operational deadlines of summer 2003 and 2004,⁶ pre-construction activities must begin by
24

25 ⁵Pursuant to the ISO's comprehensive transmission planning and approval process, the
26 ISO Governing Board on January 27, 2000 approved the Tri-Valley Project as the preferred
27 transmission alternative to address the identified reliability concerns on the ISO Grid.

28 ⁶The Vineyard and North Livermore substations are scheduled to be operational by
(continued . . .)

1 March 2002 and construction must begin no later than June 2002. PG&E intends to start
2 construction on June 1, 2002 on the Vineyard substation, August 1, 2002 on the North
3 Livermore substation, and June 1, 2003 on the North Dublin substation.

4 The Tri-Valley area is currently served by both 230 kV and 60 kV transmission
5 facilities. Nine 230 kV transmission lines run along the perimeter of the Tri-Valley area
6 with 230 kV distribution substations at San Ramon and Las Positas. Four 60 kV
7 transmission lines run through the center of the Tri-Valley area and converge at the Vineyard
8 and Radium 60 kV distribution substations. The 60 kV transmission facilities at peak
9 conditions are currently operating at or above their maximum load-serving capability. New
10 transmission infrastructure is needed to meet the continuing increase in electric demand.

11 The electric distribution system in the Tri-Valley area consists of both 12 kV and
12 21 kV systems. The 12 kV system is served off the 60 kV system and supplies the Vasco,
13 Livermore, Radium, Parks and Sunol substations, which at peak conditions are loaded at
14 capacity. The Tri-Valley Project does not include a plan to install more substation capacity
15 on the 12 kV distribution system due to the 60 kV system constraint. Rather, load will be
16 transferred, as needed, from the 12 kV to the more economical 21 kV system to prevent
17 overloads on the 12 kV system.

18
19 B. Tri-Valley Project Cost

20 In October 1999, PG&E's Board of Directors approved an appropriation of \$81
21 million to fund PG&E's proposed Tri-Valley Project. As part of the changes to the Project
22 ordered by the CPUC (discussed below), PG&E is required to underground an additional
23 seven miles of transmission lines. The cost to underground more transmission lines
24 increased the original project estimate of \$81 million to PG&E's current cost estimate of

25 (. . . continued)
26 summer 2003; the North Dublin substation is scheduled to be operational by summer 2004.
27 Between now and the installation of the Tri-Valley Project, PG&E plans to implement small
28 capital upgrades and operating solutions to accommodate the Tri-Valley near-term load
growth.

1 \$135.8 million.⁷ On November 29, 2001, PG&E submitted a notice and description of the
 2 Tri-Valley Project to the Committee, and on December 12, 2001, the Committee notified
 3 PG&E that it did not oppose the Tri-Valley Project but requested updates on critical events
 4 leading to actual cash outlays. On December 19, 2001, PG&E's Board of Directors
 5 approved updated capital expenditures in the aggregate amount of \$135.9 million to
 6 construct the CPUC-approved Tri-Valley Project, subject to Bankruptcy Court approval.⁸
 7 Fong Decl. ¶3.

8 In addition to being the only CPUC-certified approach for providing the electric
 9 transmission and distribution capacity required to serve the projected loads in the Tri-Valley
 10 area, the Tri-Valley Project is the lowest cost alternative to serve new electric customer
 11 demand in the Tri-Valley area. Based on preliminary design estimates of the CPUC
 12 approved route for the Project, PG&E estimates that the Tri-Valley Project will cost the
 13 following per year:

<u>Business Unit</u>	<u>Prior Years</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>Total</u>
Elec. Distr.	\$7.2M	\$6.2M	\$15.0M	\$9.8M	\$38.2M
Elec. Trans.	\$5.5M	\$40.0M	\$40.3M	\$11.9M	\$97.7M
Total	\$12.7M	\$46.2M	\$55.3M	\$21.7M	\$135.9M

17 Fong Decl. Ex. A.

18 The overall Tri-Valley Project has an estimated negative net present value

20
 21 ⁷ As PG&E witnesses testified before the CPUC in PG&E's opening testimony
 22 submitted in January 2001 and during the February 2001 hearings, the relative per-mile cost
 23 of constructing underground transmission line in the Tri-Valley Project is substantially more
 24 than the cost of constructing overhead transmission line. This \$55 million increase in the
 25 Tri-Valley Project cost estimate reflects not only the increase in costs related to the
 26 additional miles of underground transmission line, but also associated indirect costs such as
 27 contingency costs (which are calculated as a percentage of the subtotal of labor, material,
 28 contract and other direct costs).

⁸ Different applications of rounding methodologies explain the difference between the
 \$135.8 million cost estimate figure used at the CPUC hearing, on the one hand, and the
 \$135.9 million cost authorization sought and obtained from PG&E's Board of Directors, on
 the other. The chart that follows in the text is the same chart that was presented to the Board
 of Directors and therefore adds up to \$135.9 million.

1 ("NPV") of -\$99.4 million (-\$71.5 million for transmission cost components and -\$27.9
2 million for distribution cost components), and a present value of revenue requirements
3 ("PVR") of \$167.8 million (\$120.7 million for transmission cost components and \$47.1
4 million for distribution cost components) over the 20-year study period.⁹

5 The cost of transmission facilities is expected to be included in PG&E's base
6 utility revenue requirements and is expected to earn the rate of return authorized by the
7 Federal Energy Regulatory Commission ("FERC"). The cost of distribution facilities is
8 expected to be included in PG&E's base utility revenue requirement and is expected to earn
9 the rate of return authorized by the CPUC.

10
11 C. The CPUC's Issuance of a CPCN for the Tri-Valley Project

12 In November 1999, PG&E submitted an application to the CPUC for a CPCN
13 authorizing the construction of the Tri-Valley Project. In January and February 2001, PG&E
14 submitted written and oral testimony of witnesses testifying to, among other things, the
15 current and projected electric demand in the Tri-Valley area, the need for the Tri-Valley
16 Project to ensure system reliability under state and federal standards, the proposed locations
17 of the Project's transmission lines and facilities, the estimated cost of construction based on
18 the preliminary design and the PG&E-proposed locations for the Tri-Valley Project
19 improvements, and the estimated costs of various alternative Project routes being evaluated
20 by the CPUC.

21 After several weeks of hearings in February 2001, the CPUC issued a proposed
22 draft decision on July 24, 2001 (the "Draft Decision"). In the Draft Decision, the CPUC
23

24 ⁹ NPV is an economic measure generally used to compare reliability projects against
25 each other when customer revenues or customers' value of a project are not constant.
26 PVR, which identifies the present value of the revenues required to pay for a project's
27 installation, is an economic measure used to compare project alternatives against each other
28 when customer revenues or benefits are constant or essentially the same. PG&E proposes to
build the Tri-Valley Project despite its negative NPV because the Project is needed to
maintain transmission system reliability and meet distribution load.

1 issued a CPCN for the Tri-Valley Project but, among other things, adopted a "cost cap" of
2 approximately \$98.0 million on project expenditures, changed the location of the new
3 Dublin Substation site, rejected the North Livermore Substation altogether, and changed the
4 proposed route and placement of transmission lines. In August 2001, PG&E filed comments
5 on the Draft Decision objecting to some of the changes in transmission line routes, the
6 change in the North Dublin Substation site, the failure to approve the North Livermore
7 Substation, and the proposed "cost cap."¹⁰

8 In October 2001, following preparation by Commissioner Wood of an Alternate
9 Proposed Decision addressing many of the concerns raised in PG&E's comments, the CPUC
10 issued the CPUC Order granting a CPCN for the Tri-Valley Project. The CPUC Order
11 approved Phase 1 of the Tri-Valley Project in its entirety, including the North Livermore
12 Substation, and adopted PG&E's recommended North Dublin Substation location. Over
13 PG&E's objections, however, the CPUC Order selected a transmission line route that
14 differed from PG&E's selected route, requiring PG&E to underground approximately an
15 additional seven miles of transmission lines, and stated that "PG&E's project costs shall be
16 capped at \$118,359,015 for the project authorized." Grider Decl. Ex. A (CPUC Order) at
17 149. This amount is approximately \$17 million less than the amount of PG&E's estimated
18 cost for the CPUC-approved project. The CPUC accepted PG&E's distribution-related costs
19 for purposes of setting the "cost cap"; the CPUC's approximately \$17 million
20 "disallowance" relates to FERC-jurisdictional transmission components of the Project.

21 In November 2001, PG&E filed an application for rehearing of the CPUC Order
22 ("Rehearing Application"), arguing that: (a) the CPUC has no statutory authority to
23 reconsider ISO's determination that the Tri-Valley Project is needed to ensure the reliability

24
25 ¹⁰ PG&E also objected to other components of the Draft Decision, including the
26 CPUC's decision to not approve Phase Two of the Project (not described herein), its lack of
27 authority under state or federal law to impose a cost cap on the Tri-Valley Project, and its
reconsideration (and rejection) of the ISO's determination that all components of the Tri-
Valley Project are needed to ensure system reliability.

1 of the electrical transmission system; (b) the CPUC has no authority under state or federal
2 law to impose a "cost cap" on the Project; (c) the CPUC Order wrongly orders PG&E to
3 show cause why the CPUC's "cost cap" should not be lowered if final detailed engineering
4 design-based construction estimates predict a materially lower cost; and (d) the CPUC
5 Order's arbitrary reductions of PG&E's costs estimates are not supported by the evidence,
6 should be reversed and other costs must be added. As of the filing of this Motion, the CPUC
7 has not ruled on the Rehearing Application.

8
9 D. PG&E's Management Approved Construction of the Tri-Valley Project

10 In deciding whether to approve construction of the Tri-Valley Project, and seek
11 Bankruptcy Court approval to expend the necessary funds, PG&E management weighed the
12 risks posed by the CPUC's "cost cap" (assuming, as PG&E must, that PG&E's Rehearing
13 Application is denied). The "cost cap" poses potential risks to completion of the Project and
14 cost recovery. After taking into account and balancing (i) the need for the Tri-Valley Project
15 to maintain reliable electrical service, (ii) PG&E's belief that the CPUC "cost cap" will not
16 interfere with either completion of the Project or cost recovery for the reasons set forth
17 below, and (iii) the amount at risk, PG&E management is willing to proceed with the Tri-
18 Valley Project despite the CPUC having purported to set the "cost cap" approximately \$17
19 million below PG&E estimated costs for the Project.¹¹ In making the Motion and seeking
20 this Court's authorization under Sections 363 and/or 105 of the Bankruptcy Code for PG&E
21 to expend up to the requisite \$135.9 million to proceed with and complete the Tri-Valley
22 Project, PG&E is not asking this Court to address or rule on whether or how PG&E may
23 seek or obtain any cost recovery for the \$17 million that exceeds the "cost cap" or otherwise
24 to make any ruling with respect to the merits of PG&E's position respecting the "cost cap."

25
26 ¹¹ PG&E's decision to proceed with the Tri-Valley Project despite the CPUC's
27 arbitrary "cost cap" does not mean that PG&E will recommend proceeding with any other
28 transmission project where the CPUC sets a "cost cap" below PG&E's estimated costs. The
risk associated with each project will be considered individually.

1 Nonetheless, a summary of PG&E's position regarding the so-called "cost cap" may be
2 helpful to the Court.

3 The CPUC asserts authority to set a "cost cap" based on Section 1005.5(a) of the
4 California Public Utilities Code, which provides:

5 Whenever the commission issues to an electrical or gas corporation a
6 certificate authorizing the new construction of any addition to or extension of
7 the corporation's plant estimated to cost greater than fifty million dollars
8 (\$50,000,000), the commission shall specify in the certificate a maximum cost
9 determined to be reasonable and prudent for the facility. The commission shall
determine the maximum cost using an estimate of the anticipated construction
cost, taking into consideration the design of the project, the expected duration
of construction, an estimate of the effects of economic inflation, and any
known engineering difficulties associated with the project.

10 PG&E contends that: (a) the CPUC has been deprived of state law authority to
11 set "cost caps" on transmission projects by the California Legislature's transfer of
12 responsibility for the electrical transmission grid to the ISO; and (b) any CPUC authority to
13 "cap" transmission projects' costs is preempted by the FERC tariff with the ISO. Through
14 the enactment of AB 1890,¹² the California Legislature created the ISO, transferred control
15 of the electrical transmission grid from the CPUC to the ISO, and ordered the ISO to submit
16 control of the transmission grid to FERC jurisdiction. The ISO now operates the
17 transmission grid pursuant to a FERC-approved tariff, which has the force of federal law.
18 See, e.g., Louisiana Pub. Serv. Comm'n v. FCC, 476 U.S. 355, 368-69 (1986). PG&E's
19 analysis of these issues is set forth more fully in its Rehearing Application, attached as
20 Exhibit B to the Grider Declaration. Because the recovery of transmission costs is under
21 FERC jurisdiction, the CPUC cannot legally constrain transmission cost recovery through
22 the imposition of a "cost cap."

23 Even the CPUC seems to concede this point, stating: "while the FERC ultimately
24 will decide how much of the costs for this project PG&E may recoup in transmission rates,
25 we believe our cost cap has bearing on the amount PG&E may seek from the FERC."

26
27 ¹²AB 1890 is codified at Sections 330 through 398.5 of the California Public Utilities
28 Code.

1 Grider Decl. Ex. A (CPUC Order) at 136-37, 147. The CPUC, however, may not prevent
2 PG&E from recovering those costs that FERC has found recoverable. Mississippi Power &
3 Light Co. v. Mississippi ex rel. Moore, 487 U.S. 354, 369-70 (1988) (no state prudence
4 review where FERC approves the rates).

5 Moreover, even if the CPUC has authority to issue a "cost cap" pursuant to
6 Section 1005.5(a) of the Public Utilities Code, PG&E may apply to the CPUC for an
7 increase in the cost cap specified in the CPCN:

8 "After the certificate has been issued, the corporation may apply to the
9 commission for an increase in the maximum cost specified in the
10 certificate. The commission may authorize an increase in the specified
11 maximum cost if it finds and determines that the cost has in fact
12 increased and that the present or future public convenience and
13 necessity require construction of the Project at the increased cost;
14 otherwise, it shall deny the application." (Cal. Pub. Util. Code
15 §1005.5(b))¹³

16 The CPUC Order recognizes such right. CPUC Order at 138, 147. In the event
17 that the actual project costs exceed the cost cap and PG&E believes that it will be fruitful to
18 approach the CPUC for an increase in the cost cap, PG&E will seek an increase pursuant to
19 Section 1005.5(b).

20 PG&E also believes it can complete the Tri-Valley Project, without violating the
21 CPCN, even if costs ultimately exceed the CPUC's "cost cap," and without seeking further
22 CPUC approval, thereby avoiding the risk of significant costs being "stranded" if the Tri-
23 Valley Project could not be completed for less than the amount of the CPUC "cost cap."
24 Even assuming that the CPUC still has authority to apply Section 1005.5 to transmission
25 projects, Section 1005.5(a) provides only that the CPUC shall "specify in the certificate a
26 maximum cost determined to be reasonable and prudent for the facility." Nothing in Section
27 1005.5(a) or anywhere else in Section 1005.5 allows the CPUC to "cap" the costs that
28 PG&E may incur on the Tri-Valley Project. Indeed, Section 1005.5(d), which states that the

¹³ Pending California Assembly Bill 47 (as amended June 25, 2001), if enacted, would amend Section 1005.5 to "provide that the application of an increase may occur before, during, or after construction."

1 CPUC may "consider whether or not the actual costs of construction are within the
2 maximum cost specified by the commission" when establishing rates that reflect the costs of
3 new construction, makes plain that the CPUC has no authority to set a "maximum" amount
4 that PG&E may spend on the Tri-Valley Project.

5 Finally, the CPUC Order requires PG&E to "file a written notice with the
6 Commission ... executed by an officer of PG&E duly authorized ... to acknowledge
7 PG&E's acceptance of the conditions set forth in Ordering Paragraphs 1 through 9,
8 inclusive, of this decision." Grider Decl. Ex. A (CPUC Order) at 151. The CPUC's "cost
9 cap" is contained in Ordering Paragraph 4. For the reasons set forth above, PG&E does not
10 believe that the CPUC may require PG&E to agree that it will not seek to recoup all of the
11 actual Tri-Valley Project costs in transmission rates. In all events, PG&E's written notice,
12 filed on December 21, 2001, affirmatively asserted PG&E's right to complete the Tri-Valley
13 Project even if actual costs exceed the CPUC's "cost cap" and to seek recovery of all Project
14 costs from FERC, even if actual costs exceed the CPUC's "cost cap." If the CPUC revokes
15 the CPCN because of such reservations, PG&E will not voluntarily construct the Tri-Valley
16 Project notwithstanding this Court's approval of the Motion. Assuming the CPUC does not
17 revoke the CPCN, PG&E can and will proceed with the Tri-Valley Project upon this Court's
18 approval of the Motion.

19
20 **III. THE TRI-VALLEY PROJECT SHOULD BE AUTHORIZED**
21 **PURSUANT TO SECTIONS 363 AND 105 OF THE**
22 **BANKRUPTCY CODE**

23 As set forth at some length in the Omnibus Cap Ex Motion, PG&E on an annual
24 basis makes approximately \$1.5 billion in capital expenditures in the ordinary course of its
25 business of providing gas and electric service to its customers. These capital expenditures
26 cut across the utility functions of the company (including electric distribution, gas
27 distribution, electric transmission, gas transmission and electric generation) and generally
28 fall into one or more of three broad categories: (1) emergency/safety projects; (2) projects

1 that are mandated by regulatory or legal orders (including projects undertaken to remain in
2 compliance with regulatory and legal requirements); and (3) other projects, such as projects
3 designed to improve the reliability of PG&E's distribution or transmission system which
4 may not be mandated by specific performance requirements. See Omnibus Cap Ex Motion
5 at 3:19-4:4.

6 The Tri-Valley Project has elements of all three expenditure categories, in that
7 the Tri-Valley Project is designed to achieve the substantial additions to the existing
8 transmission and distribution systems for the Tri-Valley Area that both the ISO and the
9 CPUC have agreed should be in place by summer 2004 to meet demand and ensure system
10 reliability.

11 As previously noted in the Cap Ex Omnibus Motion, PG&E believes that the
12 expenditures on virtually all of its capital projects as described above are within the ordinary
13 course of its business. As such, PG&E appreciates that such expenditures should be
14 permitted without notice or hearing or any Bankruptcy Court approval pursuant to 11 U.S.C.
15 Section 363(c) as a use, sale or lease of estate property in the ordinary course of business.

16 However, recognizing that few are the cases in which a debtor in possession must make well
17 over \$1 billion in capital expenditures per year due to the unique nature of its business and
18 the complex regulatory environment in which it operates, PG&E already has agreed that the
19 Committee and the Court should be apprised of and/or asked to approve PG&E's capital
20 expenditures at certain substantial materiality thresholds as established in the Omnibus Cap
21 Ex Motion and Order. See generally Omnibus Cap Ex Motion at 15:23-16:20. Thus,
22 although the Tri-Valley Project in a real sense has been conceived and will be undertaken in
23 the ordinary course of PG&E's business, PG&E seeks this Court's authority to proceed with
24 the Tri-Valley Project because the anticipated cost of the Project exceeds \$50 million, and a
25 motion and Court approval therefore are required pursuant to the Omnibus Cap Ex Motion
26 and Order.

27 PG&E has demonstrated in Part II above that the Tri-Valley Project is perceived
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1 to be an important one by PG&E's regulators, and that the proposed maximum \$135.9
2 million expenditure for such Project pursuant to the Motion will allow for the
3 implementation and completion of the Project. Accordingly, this Court plainly can and
4 should utilize its authority under Section 363 of the Bankruptcy Code to approve the capital
5 expenditure authorization for the Tri-Valley Project requested by the Motion.

6 Additionally, Section 105(a) of the Bankruptcy Code authorizes this Court to
7 "issue any order, process, or judgment that is necessary or appropriate to carry out the
8 provisions of this title." The purpose of Section 105 is "to assure the bankruptcy courts'
9 power to take whatever action is appropriate or necessary in aid of the exercise of their
10 jurisdiction." 2 Lawrence P. King, Collier on Bankruptcy ¶105.01 at 105-6 (15th ed. rev.
11 2000). For the reasons set forth above, the capital expenditure authorization for the Tri-
12 Valley Project requested by the Motion plainly will enable the Debtor to proceed responsibly
13 in discharging its duty to serve in the Tri-Valley area, and will not violate any principle or
14 precept of the Bankruptcy Code. Accordingly, pursuant to the Court's authority and
15 discretion under Section 105(a) of the Bankruptcy Code, the Court can and should grant the
16 Motion.

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CONCLUSION

For all of the foregoing reasons, PG&E respectfully requests that this Court make and enter an order granting the Motion, authorizing PG&E to enter into contractual commitments and incur the expenditure of funds up to a maximum of \$135.9 million to construct and install the Tri-Valley Project.

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Respectfully submitted,

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