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 PACIFIC GAS AND ELECTRIC COMPANY

UNITED STATES BANKRUPTCY COURT
 NORTHERN DISTRICT OF CALIFORNIA
 SAN FRANCISCO DIVISION

HOWARD
 RICE
 NEMEROVSKI
 CANADY
 FALK
 & RABKIN
 A Professional Corporation

In re

PACIFIC GAS AND ELECTRIC
 COMPANY, a California corporation,

Debtor.

Federal I.D. No. 94-0742640

Case No. 01 30923 DM

Chapter 11 Case

Date: March 25, 2002
 Time: 9:30 a.m.
 Place: 235 Pine Street, 22nd Floor
 San Francisco, California

NOTICE OF MOTION AND MOTION OF PACIFIC GAS AND ELECTRIC
 COMPANY FOR ORDER AUTHORIZING DEBTOR TO PAY CERTAIN
 CATEGORIES OF PRE-PETITION CLAIMS; MEMORANDUM OF POINTS
AND AUTHORITIES IN SUPPORT THEREOF

[SUPPORTING DECLARATION OF KEVIN J. DOWD FILED
 CONCURRENTLY HERewith]

ADD

MOT. FOR AUTH. TO PAY CERTAIN CATEGORIES OF PRE-PETITION CLAIMS

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10 The Motion is based on this Notice of Motion and Motion, the accompanying
11 Memorandum of Points and Authorities in support thereof, the Declaration of Kevin J.
12 Dowd filed concurrently herewith, the record of this case and any evidence presented at or
13 prior to the hearing on this Motion.

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INTRODUCTION

MOT. FOR AUTH. TO PAY CERTAIN CATEGORIES OF PRE-PETITION CLAIMS

1 consummation. The claims that PG&E seeks to pay either are small in dollar amount (i.e.,
2 claims of (or reduced to) \$5,000 or less), or are particular types of administrative or secured
3 claims (i.e., reclamation claims and mechanics' lien claims).

4 Of all claims filed in this case, approximately one-third seek amounts of \$5,000
5 or less. The aggregate amount of these claims is approximately \$6.7 million, or
6 approximately 0.02% in dollar amount, of all claims filed against PG&E's estate.¹ By
7 paying, at this time, certain valid claims that would inevitably be paid with cash that PG&E
8 (as a solvent debtor) currently has on hand, PG&E seeks to streamline the claims resolution
9 process and reduce the estate's post-petition interest expense. Permission to pay these
10 smaller claims and the mechanics' lien and reclamation claims would enable PG&E to
11 discharge a large administrative burden now and free up resources to deal with larger, more
12 complex claims and other reorganization issues.

13 Further, PG&E is filing, concurrently herewith, a motion seeking an order for,
14 among other things, authority to pay pre- and post-petition interest to holders of certain
15 undisputed claims (hereafter, the "Interest Payment Motion").² To the extent that the Court
16 grants the Interest Payment Motion, the early payment of this large proportion of the claims
17 against the estate will obviate the need to issue small checks for periodic interest payments
18 to thousands of claimants.

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22 ¹PG&E has designated \$5,000 as the threshold for claims to be paid on the basis that, at
23 this dollar amount, the largest number of claims are resolved for the least total dollar cost to
24 the estate. If the dollar threshold is raised to a higher amount, payment of the claims would
result in diminishing returns to the estate—i.e., the number of claims resolved would not
increase proportionately in relation to the cost.

25 ²The "Notice of Motion and Motion by Pacific Gas and Electric Company for Order
26 (A) Approving Settlement and Support Agreement by and among Plan Proponents and
27 Senior Debtholders, (B) Authorizing Payment of Pre- and Post-Petition Interest to Holders
28 Undisputed Claims in Certain Classes, (C) Authorizing Payment of Fees and Expenses of
Indenture Trustees and Paying Agents and (D) Authorizing Debtor to Enter Into Similar
Settlements" is set for hearing at the same date and time as this Motion.

1 II.

2 **FACTUAL BACKGROUND³**

3 As explained in greater detail below, by this Motion, PG&E seeks permission to
4 pay three categories of claims prior to confirmation of its Plan: (1) valid claims for amounts
5 of \$5,000 or less; (2) valid mechanics' lien claims; and (3) valid reclamation claims.

6
7 **A. Valid Claims For Amounts Equal To Or Less Than \$5,000.⁴**

8 Almost a third of all claims filed in this case seek amounts equal to or less than
9 \$5,000 (the "Small Claims").⁵ PG&E estimates that 4,124 of the total filed claims are in
10 this category.⁶ Many of the claimants who filed Small Claims are individuals or small
11 businesses. Typical of the claimants in this category are trade creditors with claims for
12 goods or services provided to PG&E, and customers seeking reimbursement for damages
13 suffered to personal property (such as appliances) due to, for example, power outages or
14 surges.

15 While the Small Claims represent a relatively large number of filed claims, such
16 claims represent a very small percentage of the total dollar amount of claims filed in the
17 case. The Small Claims aggregate approximately \$6.7 million, or about 0.02% of the total
18
19

20 ³The evidentiary basis and support for the facts set forth in this Motion are contained in
21 the Declaration of Kevin J. Dowd filed concurrently herewith.

22 ⁴The proposed treatment would apply to claims greater than \$5,000 that are reduced
voluntarily by the claimant to \$5,000.

23 ⁵ This Motion generally refers to claims that have been filed against the Debtor
24 pursuant to proofs of claim. However, PG&E believes that the filed claims significantly
25 overstate PG&E's liability. In fact, PG&E's analysis shows that, of the Small Claims filed
26 against the estate, more than 10% are duplicate or late-filed claims. PG&E believes that its
Amended Schedules filed herein present a far more accurate picture of PG&E's liability for
pre-petition claims. Scheduled claims in amounts of \$5,000 or less represent 70% of all
scheduled claims.

27 ⁶All calculations referred to in this Motion are approximate; they represent PG&E's
28 current analysis, which will be refined as PG&E's reconciliation of the large number of
claims filed herein continues.

1 dollar amount of the remaining claims filed in this case.⁷ The proposed payment in full of
2 such claims would involve a sum that is not large in the context of this case, particularly in
3 light of the large number of claims that this amount would satisfy.

4
5 **B. Claims Arising Out Of Mechanics' Liens.**

6 There are approximately 50 claims asserting mechanics' liens filed against the
7 estate, totaling approximately \$10.2 million. These claims represent a relatively small
8 percentage of the total claims against the estate. Such secured claims would inevitably be
9 entitled to full payment, or its economic equivalent, in this solvent debtor case. PG&E
10 submits that payment of these claims now will reduce the estate's post-petition interest
11 expense and ease the administrative burden of resolving these claims.⁸

12
13 **C. Reclamation Claims.**

14 Certain sellers of goods have filed reclamation claims seeking the return of goods
15 delivered to PG&E immediately prior to or shortly after the filing of its Chapter 11 petition.
16 Approximately 50 such claims have been filed against the estate, aggregating approximately
17 \$5.5 million.⁹ This category of claims represents less than 0.02% of the total dollar amount
18 of the remaining claims filed against the estate.

19 The Bankruptcy Code honors statutory or common law rights of a seller of goods
20 to reclaim goods sold to the debtor in the ordinary course of the seller's business, if the seller
21 satisfies certain requirements set forth in Bankruptcy Code Section 546(c).¹⁰ Valid

22
23 ⁷The Court has previously disallowed the claims of Baldwin & Associates and Wayne
24 Roberts, in the aggregate amount of \$9 billion.

25 ⁸While PG&E's examination of these claims is not yet complete, it expects that the
26 amount that will be required to satisfy these claims will be no more than \$10.2 million.

27 ⁹One claim for approximately \$1 million has been withdrawn.

28 ¹⁰Such requirements include the debtor's insolvency at the time of receipt of the goods.
Although PG&E maintains that it was solvent at the time of receipt of the goods subject to
reclamation claims and remains solvent, it seeks to avoid the potentially time-consuming and
expensive litigation regarding its solvency that would be required in contesting these claims.

1 reclamation claims may be granted administrative expense priority under Section 503(b) of
2 the Bankruptcy Code as a replacement for the unpaid seller's right of reclamation, or may be
3 treated as secured claims. 11 U.S.C. §546(c)(2)(A); see also 5 Lawrence P. King, Collier on
4 Bankruptcy ¶546.03[2][a], at 546-21 (15th ed. rev. 2001); id. ¶503.05[4], at 503-22.

5 PG&E believes that these three categories of claims eventually will be fully paid
6 with interest. PG&E is solvent and has the cash required to pay these claims now.¹¹
7 Accordingly, there is no benefit to the estate or to creditors in requiring these claimants to
8 await payment until consummation of a Chapter 11 plan in this case. Moreover, PG&E's
9 proposed approach creates no disadvantage to any other creditor or class of creditors. In
10 fact, PG&E's proposal would yield benefits to the estate in that a significant amount of
11 administrative work would be done at an earlier stage in the claims resolution process,
12 leaving PG&E resources available to deal with much larger, more complex claims and the
13 other demands of reorganization. A further benefit is that paying these claims pre-
14 confirmation reduces PG&E's ongoing liability for post-petition interest expense related to
15 such claims. Further, the payment of these claims would eliminate the administrative burden
16 and cost of paying interest on an ongoing basis with respect to these claims, if the Interest
17 Payment Motion is granted.

18
19 **D. PG&E's Proposal For Payment Of Claims Described Herein.**

20 If the Court grants this Motion, PG&E will pay all undisputed claims of \$5,000 or
21 less, as well as valid reclamation and mechanics' lien claims, on or before July 31, 2002,
22 together with post-petition interest at the federal judgment rate in effect on April 6, 2001 (the
23 date of the filing of PG&E's Chapter 11 petition)—4.19% per annum—accrued on the
24 allowed amount of such claims from April 6, 2001 through June 30, 2002. With respect to
25 disputed claims, upon the resolution of such claims, either by Court order or settlement,

26
27 ¹¹As reflected in PG&E's December Monthly Operating Report, PG&E had more than
28 \$4.2 billion in cash reserves as of December 31, 2001.

1 PG&E proposes to pay the allowed amount of those claims, plus interest at the federal
2 judgment rate (4.19% per annum), accrued from April 6, 2001 through the date of payment.
3 Such payments would be made on a monthly basis from and after August 1, 2002, with
4 respect to those claims that have been resolved during the prior month (e.g., claims that are
5 resolved in July 2002 would be paid in August 2002; claims resolved in August 2002 would
6 be paid in September 2002, and so on).

8 III.

9 DISCUSSION

11 A. PG&E Should Be Authorized To Pay The Small Claims, The Mechanics' 12 Lien Claims And The Reclamation Claims Pursuant To Section 363(b)(1) Of 13 The Bankruptcy Code On The Basis That It Makes Sound Business Sense To 14 Pay These Categories Of Claims Pre-Confirmation.

15 PG&E should be authorized to pay the three categories of claims discussed above
16 pursuant to Section 363(b)(1) of the Bankruptcy Code, which provides that "[t]he trustee,
17 after notice and a hearing, may use, sell, or lease, other than in the ordinary course of
18 business, property of the estate." 11 U.S.C. §363(b)(1).

19 In determining whether to authorize a transaction under Section 363(b)(1), courts
20 require a debtor to show that a sound business purpose justifies such actions, applying the
21 business judgment test. See, e.g., Stephens Indus., Inc. v. McClung, 789 F.2d 386, 389-90
22 (6th Cir. 1986); Comm. of Equity Sec. Holders v. Lionel Corp. (In re Lionel Corp.), 722
23 F.2d 1063, 1071 (2d Cir. 1983); see also 3 Lawrence P. King, Collier on Bankruptcy
24 ¶363.02[1][g] (15th ed. rev. 1998).

25 The burden of establishing a valid business purpose for a transaction outside the
26 ordinary course of business falls upon the debtor. See In re Lionel Corp., 722 F.2d at 1066.
27 Once the debtor has articulated a rational business justification, however, a presumption
28 attaches that the decision was made "on an informed basis, in good faith and in the honest
belief that the action taken was in the best interest of the [debtor]." See, e.g., Official

1 Comm. of Subordinated Bondholders v. Integrated Res., Inc. (In re Integrated Res., Inc.),
2 147 B.R. 650, 656 (S.D.N.Y. 1992) (citing Smith v. Van Gorkom, 488 A.2d 858, 872 (Del.
3 1985)).

4 Here, sound business justifications exist for PG&E's pre-confirmation payment
5 of the Small Claims, the mechanics' lien claims and the reclamation claims described above.
6 PG&E will be able to resolve these three categories of claims by paying no more (and
7 probably substantially less) than \$22.4 million in total. PG&E is solvent and has the cash on
8 hand to pay these claims. Accordingly, the authorization sought by PG&E would benefit the
9 estate by reducing post-petition interest costs¹² and streamlining the claims resolution
10 process, thereby allowing PG&E to focus those resources involved in the claims process on
11 larger, more complex claims. Finally, to the extent that the Court grants the Interest
12 Payment Motion, granting this Motion would relieve the estate of the administrative burden
13 and costs associated with issuing thousands of small checks for periodic interest payments to
14 these claimants.

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16 **B. Payment Of The Small Claims And The Mechanics' Lien And Reclamation**
17 **Claims Is Practical, "Legal And Factually Inevitable," And In The Best**
18 **Interests Of Creditors And The Estate; Thus The Court Should Order Such**
19 **Payment Under Section 105 Of The Bankruptcy Code.**

20 Although courts demonstrate some reluctance in allowing payment of pre-petition
21 claims prior to the confirmation of a plan in a Chapter 11 case, the Court has the power
22 under Section 105 of the Bankruptcy Code to order the payment of pre-petition claims where
23 circumstances warrant. In doing so, courts have been guided primarily by "practicality and
24 common sense" and the "legal or factual inevitability of payment." In re Payless Cashways,
25 Inc., 268 B.R. 543, 547 (Bankr. W.D. Mo. 2001); In re EqualNet, 258 B.R. at 368.

26 ¹²As explained in the Interest Payment Motion and the Declaration of Kent Harvey
27 filed in support thereof, PG&E's estate is incurring unnecessary interest expenses and
28 suffering a form of negative arbitrage in that the rate at which the Debtor must accrue and
compound accrued interest is significantly higher than the rates that the Debtor is earning on
its cash holdings in today's financial markets. Interest Payment Motion at 4; Declaration of
Kent Harvey ¶6.

1 Section 105 authorizes the court to “issue any order, process, or judgment that is
2 necessary or appropriate to carry out the provisions of this title.” The purpose of Section
3 105 is “to assure the bankruptcy court’s power to take whatever action is appropriate or
4 necessary in aid of the exercise of its jurisdiction.” 2 Lawrence P. King, Collier on
5 Bankruptcy ¶105.01, at 105-106 (15th ed. rev. 2000); see, e.g., Crafts Precision Indus., Inc.
6 v. U.S. Healthcare, Inc. (In re Crafts Precision Indus., Inc.), 244 B.R. 178, 183 (B.A.P. 1st
7 Cir. 2000) (affirming authorization of vacation payments “pursuant to §105, irrespective of
8 them being non-priority obligations”); Michigan Bureau of Workers’ Disability Corp. v.
9 Chateaugay Corp. (In re Chateaugay Corp.), 80 B.R. 279, 287 (S.D.N.Y. 1987) (bankruptcy
10 court has equitable power, in pre-plan stage of reorganization proceeding, to authorize
11 debtor-in-possession to pay pre-petition debt and to allow debtor to pay some creditors in
12 class without paying others without violating Bankruptcy Code, as a “rigid application of the
13 priorities of §507 would be inconsistent with the fundamental purpose of reorganization and
14 of the [Bankruptcy Code’s] grant of equity powers to bankruptcy courts, which is to create a
15 flexible mechanism that will permit the greatest likelihood of survival of the debtor and
16 payment of creditors in full or at least proportionately”); see also In re Payless, 268 B.R. at
17 547.

18 In Payless, the bankruptcy court approved preferential payments of the pre-
19 petition claims of certain suppliers to enable the debtor to obtain post-petition credit. The
20 Payless court acknowledged that “the Code recognizes that the court has some limited power
21 to authorize preferential treatment to certain creditors. The question is when it is appropriate
22 to exercise that power.” Id. at 546. The court considered various factors, such as whether
23 the subject transaction “confers a benefit on the estate and its creditors, not just the payees”
24 and “[t]he extent to which there is unanimous support or strong disagreement from the
25 creditor body.” Id. at 547. The Payless court also noted that the amount to be paid to such
26 suppliers on account of their pre-petition claims represented less than 2% of the debtor’s
27 total pre-petition debt. Id. In each instance, however, the overarching consideration is that
28 “the court must be guided by practicality and common sense.” 268 B.R. at 546; see also In

1 re EqualNet, 258 B.R. at 369 (bankruptcy court authorized debtors to pay pre-petition claim
2 tantamount to priority wages asserted by a contract employee, noting that exceptions to
3 general rule against preconfirmation payment of pre-petition claims “arise primarily out of
4 common sense and the presence of a legal or factual inevitability of payment”) (emphasis
5 added); In re Public Serv. Co., 107 B.R. 441, 447 (Bankr. D.N.H. 1989) (allowing refund of
6 pre-petition customer deposits—“it is obvious that these commercial deposit refund rights
7 will ultimately be honored and no good purpose is served in withholding such payments to
8 protect against any alternative result that may occur by virtue of the reorganization”).

9 Payment of the Small Claims is a practical and fair approach to dealing with the
10 thousands of Small Claims filed against the estate. PG&E anticipates that, in reality, it will
11 cost \$4.7 million to satisfy such Claims. PG&E has more than sufficient cash on hand to
12 pay these claims. Similarly, the valid reclamation and mechanics’ lien claims also involve a
13 relatively small amount of money, and payment of these claims will benefit suppliers, with
14 which, in many cases, the Debtor maintains ongoing relationships, and which will inevitably
15 be fully paid. Accordingly, the relief sought in this Motion would benefit the estate by
16 reducing post-petition interest expense and streamlining the claims resolution process,
17 thereby allowing PG&E to focus its resources on larger, more complex claims, without
18 prejudicing any class of creditors.

19 PG&E submits that, in the interests of the efficient administration of the estate, it
20 would be fair and reasonable not to make individuals and small business claimants with
21 valid claims await the effective date of a confirmed plan before being paid on such claims.
22 PG&E is solvent and has sufficient cash on hand to pay these large numbers of relatively
23 small claims without causing any detriment to other creditors.

24 25 IV.

26 CONCLUSION

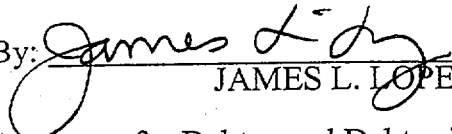
27 For all of the foregoing reasons, PG&E respectfully requests that this Court enter
28 its Order granting the Motion and such other and further relief as the Court deems just and

1 appropriate.

2
3 DATED: March 5, 2002.

Respectfully,

HOWARD, RICE, NEMEROVSKI, CANADY,
FALK & RABKIN
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By: 
JAMES L. LOPES

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

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