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8

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

12 In re

13 PACIFIC GAS and ELECTRIC
COMPANY, a California corporation,
14

Debtor.
15

16
17 Federal I.D. No. 94-0742640
18
19
20

Case No. 01-30923 DM

Chapter 11 Case

Date: July 28, 2003

Time: 1:30 p.m.

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

Judge: Hon. Dennis Montali

21 DEBTOR'S NOTICE OF MOTION AND MOTION FOR AN ORDER AUTHORIZING
22 COMPROMISE OF CLAIMS OF DAIRY PROPERTY OWNER/OPERATORS AND
MEMORANDUM OF POINTS AND AUTHORITIES IN SUPPORT THEREOF
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MOTION FOR ORDER AUTH. COMP. OF CLAIMS OF DAIRY PROPERTY OWNER/OPERATORS

HOWARD
RICE
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CANADY
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& RABKIN
A Professional Corporation

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1 **NOTICE OF MOTION AND MOTION**

2 **PLEASE TAKE NOTICE** that on July 28, 2003, at 1:30 p.m., or as soon thereafter as
3 the matter may be heard, in the Courtroom of the Honorable Dennis Montali, located at 235
4 Pine Street, 22nd Floor, San Francisco, California, Pacific Gas and Electric Company, the
5 debtor and debtor in possession in the above-captioned Chapter 11 case ("PG&E" or the
6 "Debtor"), will and hereby does move the Court for entry of an order authorizing PG&E to
7 enter into, and perform its obligations under, a Settlement Agreement and Release resolving
8 ongoing claims of certain private parties for damage to a dairy farm operation and related
9 land caused by contamination alleged to have arisen out of PG&E's nearby compressor
10 station in Hinkley, California (the "Compressor Station" or the "Station"), pursuant to Rule
11 9019(a) of the Federal Rules of Bankruptcy Procedure and Section 105(a) of the United
12 States Bankruptcy Code (11 U.S.C. §105(a)).

13 This Motion is based on the facts and law set forth herein (including the following
14 Memorandum of Points and Authorities), the accompanying Declaration of Robert C. Doss,
15 the record of this case, and any evidence presented at or prior to the hearing on this Motion.

16 The Official Committee of Unsecured Creditors has reviewed this Motion, and its
17 signature following the Memorandum of Points and Authorities below evidences that it has
18 no objection to the granting of the relief sought herein.

19 **PLEASE TAKE FURTHER NOTICE** that pursuant to Rule 9014-1(c)(2) of the
20 Local Bankruptcy Rules for the Northern District of California, any written opposition to the
21 Motion and the relief requested therein must be filed with the Bankruptcy Court and served
22 upon appropriate parties (including counsel for PG&E, the Office of the United States
23 Trustee and the Official Committee of Unsecured Creditors) at least five (5) days prior to the
24 scheduled hearing date. If there is no timely objection to the requested relief, the Court may
25 enter an order granting such relief without further hearing.

1 MEMORANDUM OF POINTS AND AUTHORITIES

2 INTRODUCTION

3 PG&E commenced this Chapter 11 case by the filing of a voluntary petition on April 6,
4 2001. PG&E continues to manage and operate its property as a debtor in possession
5 pursuant to Sections 1107 and 1108 of the Bankruptcy Code. PG&E submits this brief in
6 support of its Motion For An Order Authorizing Compromise Of Claims Of Dairy Property
7 Owner/Operators (the "Motion"). By the Motion, PG&E seeks approval of that certain
8 Settlement Agreement and Release dated May 17, 2003 (the "Settlement Agreement") with
9 certain private property owners and operators, a copy of which is attached as Exhibit A to
10 the Declaration of Robert C. Doss filed concurrently herewith (the "Doss Decl."). Certain
11 private parties have asserted claims against PG&E for damage to a dairy farm operation and
12 related land caused by groundwater contamination alleged to have arisen from PG&E's
13 Compressor Station. Under the Settlement Agreement, these private parties would release
14 their claims against PG&E, PG&E would pay cash consideration to the parties, and PG&E
15 and the parties would enter into certain agreements for the sale, leaseback, and option to
16 purchase of the dairy farm property. Besides resolving the property damage and business
17 interruption claims of the private parties, the proposed settlement would allow PG&E to gain
18 control over the property in order to construct a groundwater treatment system and install
19 groundwater extraction and monitoring wells on the property. This would allow PG&E to
20 meet its regulatory obligations to clean up the groundwater in the area and would help
21 prevent the further migration of contaminated groundwater in the area.

22
23 FACTUAL BACKGROUND

24 A. General.

25 PG&E has owned and operated the Compressor Station for over 50 years. In its prior
26 operations at the Station, PG&E used a chromium-based product to reduce corrosion in its
27 cooling systems. Beginning in the 1980's, the Lahontan Regional Water Quality Control
28 Board ("LRWQCB") ordered PG&E to clean up and abate the effects of chromium in

1 groundwater at and in the vicinity of the Station. These LRWQCB orders (as amended from
2 time to time, the "LRWQCB Orders") remain in effect to this day. In response to the
3 LRWQCB Order, PG&E put in place two land treatment units ("LTUs"). The LTUs served
4 to remove chromium from the groundwater in the vicinity of the Station and to prevent the
5 further migration of contaminated groundwater to other areas. In June of 2001, however,
6 PG&E was ordered by the LRWQCB to cease operating the LTUs due to the LRWQCB's
7 concerns that the LTUs had the potential to contribute chromium to nearby air.

8 Nick VanVliet and Paul Ryken (collectively, the "Operators") operate a dairy farm
9 located at 37501 Mountain View, Hinkley, California (the "Property"), which is situated
10 approximately 1.5 miles from the Station. The Property consists of approximately 150 acres
11 of land containing various housing and farm-related structures and improvements. The
12 Property is owned by K&H VanVliet Children LLC (the "Owner") and is leased to the
13 Operators for use as a dairy farm.

14 At the time that PG&E filed its petition in this case, no chromium levels above the
15 drinking water standard had been detected in the groundwater at the Property. PG&E
16 believes that, as of the petition date, the LTUs were effective in containing the spread of
17 chromium in the groundwater in the vicinity of the Station. In March 2002, however, less
18 than a year after it was required to shut down the LTUs, chromium levels in excess of 50
19 parts per billion, the California drinking water standard, were detected for the first time at
20 the Property.¹

21 After these chromium levels were discovered at the Property, the Owner and Operators
22 (collectively, the "Owner/Operators") ceased using the groundwater from wells at the
23 Property to irrigate their alfalfa fields and, in order to compensate the Owner/Operators for
24 the loss of alfalfa grown from the Property, PG&E agreed to purchase alfalfa for the
25 Operators to be used as feed for their dairy herd. In addition, the Owner/Operators asserted
26

27 ¹Due to the timing of these events, PG&E believes that the Owner/Operators' claims
28 would be deemed to have arisen post-petition. (See Part B of Argument below.)

1 certain claims against PG&E alleging that the dairy farm business and the Property itself had
2 been injured as a result of the contamination. Thereafter, PG&E and the Owner/Operators
3 entered into settlement discussions. PG&E's goals in such discussions included not only
4 resolving the Owner/Operators claims, but more importantly from PG&E's perspective,
5 obtaining control over the Property so that PG&E could construct a groundwater treatment
6 system and install groundwater extraction and monitoring wells (collectively, the
7 "Groundwater Treatment System") at the Property, thereby preventing the further migration
8 of the chromium in the groundwater towards third-party landowners and operators that could
9 be affected by such migration. PG&E has been advised by its engineering consultants that
10 the Property represents the optimum location for the Groundwater Treatment System from
11 the standpoint of preventing further migration of chromium in groundwater.

12
13 **B. Settlement Agreement.**

14 After lengthy negotiations, PG&E and the Owner/Operators have agreed to a
15 settlement of the Owner/Operators' claims as described in detail in the Settlement
16 Agreement. The Settlement Agreement is conditioned upon the entry of a final order
17 granting this Motion. The basic terms of the settlement are as follows:

18 1. **Cash Payment.** PG&E would pay to the Owner/Operators a cash sum of
19 \$300,000 promptly following the Court's approval of this Motion ("Court Approval"). If
20 Court Approval is not obtained within 30 days of the execution of the Settlement
21 Agreement, PG&E would also pay the Owner/Operators interest on the \$300,000 at an
22 annual rate of 5%.

23 2. **Purchase And Sale Of Real Property.** PG&E would purchase fee title to the
24 Property from the Owner for the sum of \$3,700,000. PG&E would attempt to purchase the
25 Property through the exercise of its powers of condemnation, but if such purchase could not
26 be completed within a specified period of time, PG&E would purchase the Property directly
27 from the Owner in a private transaction. PG&E would purchase the Property "AS IS"
28 without any representations or warranties from the Owner. As part of the purchase, the

1 Owner would convey to PG&E 576 acre-feet of water rights. If Court Approval is not
2 obtained within 30 days of the execution of the Settlement Agreement, PG&E would also
3 pay the Owner/Operators interest on the \$3,700,000 at an annual rate of 5%.

4 3. Lease. PG&E and the Operators (or an affiliated entity) would enter into a
5 lease for the Property (the "Lease") pursuant to which PG&E would lease back the Property
6 to the Operators (or an affiliated entity) rent free for a period of nine years commencing on
7 the date that PG&E purchases the Property from the Owner.² The Operators would be
8 responsible for maintaining and repairing the Property and paying all utilities. Under the
9 Lease, PG&E would retain a license to undertake and perform on the Property all actions
10 and activities necessary to remediate the groundwater underlying the Property in accordance
11 with the LRWQCB's requirements, which would include the right to (i) construct and install
12 the Groundwater Treatment System; (ii) obtain samples of soil and vegetation from the
13 Property in conjunction with the monitoring of the treatment system; (iii) use water rights to
14 perform extraction and treatment of groundwater; and (iv) carry out tasks necessary to
15 comply with LRWQCB orders or directives.

16 4. Option To Purchase. Under the Lease, PG&E would grant the Operators (or
17 an affiliated entity) the option to purchase the Property (the "Option") at any time prior to
18 the expiration of the Lease for a purchase price of \$2 million and otherwise substantially in
19 accordance with the form of purchase and sale agreement attached to the Lease. If the
20 Operators exercise the Option, the Lease provides that the Operators would grant to PG&E
21 an easement in the form attached to the Settlement Agreement which would permit PG&E to
22 (i) continue to operate the Groundwater Treatment System on the Property, (ii) obtain
23 samples of soil and vegetation from the Property in conjunction with the monitoring of the
24 treatment system; (iii) use water rights to perform extraction and treatment of groundwater;

25
26 ²Effective as of January 1, 2003, PG&E would no longer be required to provide the
27 Operators with alfalfa or pay out-of-pocket expenses for manure disposal, both of which
28 PG&E has been paying until additional water for these needs can be arranged, the cost of
which is roughly equivalent to the rental that the Operators are now paying the Owner for
the Property.

1 and (iv) carry out tasks necessary to comply with LRWQCB orders or directives. The
2 easement would continue until the LRWQCB issues a "no further action" letter to PG&E or
3 makes a similar finding or determination that PG&E is not required to conduct further
4 remediation activities concerning the remediation of chromium near the Property or the
5 Compressor Station.

6 5. Release. Under the Settlement Agreement, the Operators would release
7 PG&E from all claims for injury to the business or operations of the dairy operations at the
8 Property, provided that the release would not cover (i) personal injury claims, (ii) claims for
9 business interruption or business injury which caused the dairy operations at the Property to
10 cease or substantially restrict operations in the future due to the presence of chromium, (iii)
11 claims relating to the operation of the Groundwater Treatment System at the Property, and
12 (iv) claims for contribution and indemnity for claims against the Operators by any individual
13 or entity arising from the presence of chromium in the groundwater at or near the Station or
14 the Property. The Owner would release PG&E from all claims for injury to the Owner's
15 business, real property, personal property or goodwill, provided that the release would not
16 cover (x) personal injury claims, and (y) claims for contribution and indemnity for claims
17 against the Owner by any individual or entity arising from the presence of chromium in the
18 groundwater at or near the Station or the Property.

19 20 ARGUMENT

21 A. The Court Should Approve The Settlement.

22 Bankruptcy Rule 9019(a) empowers a bankruptcy court to approve any settlement or
23 compromise related to a reorganization or liquidation.³ Myers v. Martin (In re Martin), 91
24 F.3d 389, 393 (3d Cir. 1996); Vaughn v. Drexel Burnham Lambert Group, Inc. (In re Drexel
25 Burnham Lambert Group, Inc.), 134 B.R. 499, 505 (Bankr. S.D.N.Y. 1991). Indeed,

26
27 ³Bankruptcy Rule 9019(a) simply states, in part, that "[o]n motion by the trustee and
28 after notice and a hearing, the court may approve a compromise or settlement." Fed. R.
Bankr. P. 9019(a).

1 compromises and settlements are a common and favored occurrence in bankruptcy cases
2 because they allow a debtor and its creditors to avoid the financial and other burdens
3 associated with litigation over contentious issues and expedite the administration of the
4 bankruptcy estate. Protective Comm. for Indep. Stockholders of TMT Trailer Ferry, Inc. v.
5 Anderson, 390 U.S. 414, 424 (1968); Martin v. Kane (In re A & C Props.), 784 F.2d 1377,
6 1380-81 (9th Cir. 1986).

7 In reviewing a proposed settlement, the bankruptcy court's inquiry focuses only upon
8 whether the compromise is fair and equitable and in the best interest of the estate. TMT
9 Trailer, 390 U.S. at 424; A & C Props., 784 F.2d at 1380-81; Nellis v. Shugrue, 165 B.R.
10 115, 121 (S.D.N.Y. 1994). In making this determination, however, the bankruptcy court is
11 not required to conduct a mini-trial on the merits of the underlying dispute or an independent
12 investigation into the reasonableness of the settlement. Port O'Call Inv. Co. v. Blair (In re
13 Blair), 538 F.2d 849, 851 (9th Cir. 1976); see also In re Purofied Down Prods. Corp., 150
14 B.R. 519, 522 (S.D.N.Y. 1993); Drexel Burnham, 134 B.R. at 505.

15 Rather, the standards for such approval have been described as lenient and intended to
16 encourage approval of settlements in bankruptcy cases. See Purofied Down, 150 B.R. at
17 522-23. The bankruptcy court need only canvass the legal and factual issues underpinning
18 the compromise to ensure that the proposed settlement does not fall "below the lowest point
19 in the range of reasonableness." Nellis, 165 B.R. at 121-22 (quoting Cosoff v. Rodman (In
20 re W.T. Grant Co.), 699 F.2d 599, 608 (2d Cir. 1983)); Purofied Down, 150 B.R. at 522;
21 Official Unsecured Creditors' Comm. of Pennsylvania Truck Lines, Inc. v. Pennsylvania
22 Truck Lines, Inc. (In re Pennsylvania Truck Lines, Inc.), 150 B.R. 595, 598 (E.D. Pa. 1992),
23 aff'd mem., 8 F.3d 812 (3d Cir. 1993); Drexel Burnham, 134 B.R. at 505. In making this
24 determination, significant deference may be given to the informed judgment of the debtor in
25 possession and its counsel that a proposed compromise is fair and equitable. Martin, 91 F.3d
26 at 395; Nellis, 165 B.R. at 122; Purofied Down, 150 B.R. at 522-23; Drexel Burnham, 134
27 B.R. at 505.

28 Over the years, four significant criteria have been developed by the courts for
MOTION FOR ORDER AUTH. COMPROMISE OF CLAIMS OF PROPERTY OWNER/OPERATORS

1 consideration in determining whether a proposed settlement falls below the lowest point in
2 the range of reasonableness: (1) the probability of success on the merits; (2) the difficulties,
3 if any, to be encountered in the matter of collection; (3) the complexity of the litigation
4 involved, and the expense, inconvenience and delay necessarily attending it; and (4) the
5 paramount interest of the creditors and a proper deference to their reasonable views. A & C
6 Props., 784 F.2d at 1381; see also Martin, 91 F.3d at 393; Nellis, 165 B.R. at 122;
7 Pennsylvania Truck Lines, 150 B.R. at 598. As demonstrated below, each of the applicable
8 criteria is satisfied here.⁴

9
10 1. The Probability Of Success On The Merits.

11 The Settlement Agreement would resolve a significant and complex dispute between
12 the Debtor and Owner/Operators without the need for expensive, distracting and time-
13 consuming litigation. There is no guarantee that PG&E could avoid an adverse judgment as
14 to its liability for the contamination and, perhaps more significantly, the amount of damages
15 suffered by the Owner/Operators, in the event of full litigation of this matter. Furthermore,
16 PG&E would not be able to obtain control over the Property absent a settlement unless it
17 brought a separate condemnation action against the Owner/Operators, and even in that case,
18 such an action might not be successful.

19
20 2. The Complexity Of The Litigation, And The Expense, Inconvenience And
21 Delay Attending It.

22 The Settlement Agreement would resolve a complicated legal dispute involving
23 technical issues regarding the existence, extent and source of, and the harm caused by,
24 chromium contaminated groundwater at the Property, and contentious issues regarding
25 proper measure and calculation of any damages that may have resulted from the alleged
26

27 ⁴The second factor typically considered by courts—difficulty associated with
28 collection—is not applicable here.

1 contamination. Any litigation over this matter likely would involve the testimony of several
2 experts as to these issues. Accordingly, in agreeing to the Settlement Agreement, the Debtor
3 has made what it believes is an economically prudent business judgment that the estate's
4 assets are better utilized in facilitating a settlement rather than defending an action brought
5 by the Owner/Operators and prosecuting or defending an appeal of such an action.

6
7 **3. The Settlement Is In The Best Interest Of The Creditors.**

8 The last criteria considered by bankruptcy courts reviewing a proposed settlement is
9 the paramount interest of creditors, with a deference to their reasonable views. A & C
10 Props., 784 F.2d at 1381; Drexel Burnham, 134 B.R. at 505-06. While a creditor's objection
11 to a proposed settlement must be considered, it is not controlling and will not bar approval of
12 settlements that "do not fall below the lowest point in the range of reasonableness." A & C
13 Props., 784 F.2d at 1382; Drexel Burnham, 134 B.R. at 505.⁵

14 The compromise reached in the Consent Judgment benefits not only the estate but all
15 creditors. The Consent Judgment contains a resolution of claims, and more importantly,
16 allows the Debtor to obtain control over the Property and construct the Groundwater
17 Treatment System, which will, firstly, allow PG&E to comply with its obligation under the
18 LRWQCB Order and, secondly, allow PG&E to stop the migration of chromium in the
19 groundwater in the area and thus minimize further claims from private parties in the future.

20
21 **B. The Settlement Agreement Involves The Settlement Of Post-Petition Claims.**

22 On certain rare occasions, PG&E has asked this Court for authority to enter into and
23 consummate certain settlements involving pre-petition environmental claims (including
24 making payments in the settled amounts), if PG&E believed such settlements to be in the
25 best interest of the estate and its creditors. In contrast to those settlements, the Debtor does

26
27 ⁵With regard to this point, PG&E notes that the Official Committee of Unsecured
28 Creditors has no objection to this Motion as evidenced by its signature below.

1 not believe that the current settlement involves a prepetition claim. At the time PG&E filed
2 its petition in this case, there was no evidence that chromium levels above the drinking water
3 standard had reached the Property. In fact, the evidence at the time suggested that chromium
4 levels above the drinking water standard had been contained within a well-defined
5 groundwater plume and was no longer migrating. There was also no reason to believe at that
6 time that PG&E would be required to cease operating the LTUs, which resulted in the
7 chromium migrating to the groundwater underlying the Property. Given these facts, it is
8 unlikely that the Owner/Operators' claims could be said to be pre-petition claims.
9 Therefore, PG&E does not believe that the settlement would involve payment on account of
10 any pre-petition claims.⁶

11
12 C. Proposed Settlement Is Arguably In The Ordinary Course Of Business.

13 The proposed settlement is not far afield from other settlements that PG&E has entered
14 into over the years. Therefore, it reasonably could be argued that the settlement is "in the
15 ordinary course of business" and therefore permissible, without notice or a hearing or any
16 Bankruptcy Court approval, pursuant to 11 U.S.C. §363(c). Nonetheless, in an abundance of
17 caution, and to avoid potential uncertainty, PG&E believes it is appropriate in this instance
18 to seek this Court's authority to enter into the Settlement Agreement.

19
20 D. Portions Of Settlement May Be Covered By Previously Granted Omnibus
21 Motions.

22 Previously, PG&E filed and this Court approved that certain Motion for Authority to
23 Continue its Hazardous Substances Cleanup Programs (the "Omnibus Environmental
24 Motion"), which gave the Debtor authority to expend up to \$22 million in each calendar year
25 towards the cost of investigating and responding to instances of environmental

26
27 ⁶Even if the proposed settlement could be deemed to involve a prepetition claim,
28 however, PG&E believes that the settlement should nonetheless be approved as being in the
best interest of the estate and its creditors for the reasons set forth in Part A above.

1 contamination caused by, or alleged to be caused by, releases from the operations of PG&E,
2 whether such releases occurred prior to or after the filing of this case. Although the
3 proposed settlement does not come wholly within the Omnibus Environmental Motion as
4 that motion does not authorize the payment of costs to settle any claims for property damage
5 or economic losses related to contamination located on the property of third parties, there are
6 aspects of the proposed settlement that would come within the Omnibus Environmental
7 Motion. These would include, for example, payments made to acquire the Property because
8 such acquisition would directly relate to PG&E's response to alleged chromium
9 contamination emanating from the Compressor Station.

10 In addition, PG&E previously filed and this Court approved that certain Motion for
11 Authorization to Settle Post-Petition Third Party Claims in the Ordinary Course of Business
12 (the "Omnibus Settlement Motion") pursuant to which PG&E was authorized to spend up to
13 \$31 million in the aggregate during any calendar year after 2001 to settle post-petition
14 claims, excluding single settlements in excess of \$5 million. The proposed settlement does
15 not squarely fit within the Omnibus Settlement Motion because it involves material non-
16 monetary terms. To the extent, however, the terms of the Settlement Agreement could be
17 quantified monetarily, it is certainly consistent with the spirit of the Omnibus Settlement
18 Motion.

19
20 E. Court May Authorize Settlement Pursuant To Section 105 Of The Bankruptcy
21 Code And The Court's Inherent Equitable Powers.

22 As discussed above, PG&E believes this Court can utilize its authority under
23 Bankruptcy Rule 9109(a) to authorize the settlement requested by this Motion. Additionally,
24 Section 105(a) of the Bankruptcy Code authorizes a bankruptcy court to "issue any order,
25 process, or judgment that is necessary or appropriate to carry out the provisions of this title."
26 The purpose of Section 105 is "to assure the bankruptcy courts power to take whatever
27 action is appropriate or necessary in aid of the exercise of their jurisdiction." 2
28 Lawrence P. King, Collier on Bankruptcy ¶105.01, at 105-5 to 105-6 (15th ed. rev. 2000).

1 For the reason stated in Part A above, the proposed settlement embodied in the Settlement
2 Agreement is in the best interests of the Debtor and its estate. Accordingly, pursuant to the
3 Court's authority and discretion under Section 105(a) of the Bankruptcy Code, the Court can
4 and should authorize PG&E to enter into and consummate the Settlement Agreement.
5

6 **CONCLUSION**

7 The Debtor has carefully considered the risks, complexity and expense associated with
8 further litigation of the disputes between it and the Owner/Operators. In the Debtor's sound
9 business judgment, these factors tip the scale heavily in favor of approval of the proposed
10 Settlement Agreement as fair, reasonable and equitable and in the best interests of the
11 estate and its constituencies. For these reasons, the Debtor respectfully requests that the
12 Court grant its Motion and approve the Settlement Agreement in substantially the form
13 attached as Exhibit A to the Doss Declaration.

14 DATED: June 20, 2003.
15

16 Respectfully,

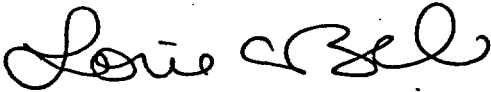
17 HOWARD, RICE, NEMEROVSKI, CANADY,
18 FALK & RABKIN
A Professional Corporation

19 By: Kenneth A. Neale
20 KENNETH A. NEALE

21 Attorneys for Debtor and Debtor in Possession
22 PACIFIC GAS AND ELECTRIC COMPANY
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1
2 THE OFFICIAL COMMITTEE OF UNSECURED CREDITORS HAS NO OBJECTION
3 TO THE FOREGOING MOTION AND THE RELIEF REQUESTED THEREIN.

4 MILBANK, TWEED, HADLEY & McCLOY LLP
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7 Attorneys for OFFICIAL COMMITTEE OF
8 UNSECURED CREDITORS

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