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PACIFIC GAS AND ELECTRIC COMPANY

UNITED STATES BANKRUPTCY COURT

NORTHERN DISTRICT OF CALIFORNIA

SAN FRANCISCO DIVISION

In re PACIFIC GAS AND ELECTRIC COMPANY, a California corporation, Debtor. Federal I.D. No. 94-0742640	No. 01-30923 DM Chapter 11 Case Date: January 5, 2004 Time: 1:30 p.m. Place: 235 Pine Street, 22nd Floor San Francisco, California Judge: Hon. Dennis Montali

HOWARD RICE NEMEROVSKI CANADY FALK & RABKIN
A Professional Corporation

DEBTOR'S NOTICE OF MOTION AND MOTION
FOR ORDER APPROVING EXPENDITURE OF FUNDS
TO REPLACE FOUR STEAM GENERATORS
AT BOTH UNIT 1 AND 2 OF THE DIABLO CANYON POWER PLANT;
<u>SUPPORTING MEMORANDUM OF POINTS AND AUTHORITIES</u>

[SUPPORTING DECLARATION OF LAWRENCE F. WOMACK
FILED SEPARATELY]

BKRP01

NOTICE OF MOTION AND MOTION

PLEASE TAKE NOTICE that on January 5, 2004, at 1:30 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 enter into contractual commitments for and incur up to $706 million in capital expenditures over a several year period in order to undertake and implement the Diablo Canyon Steam Generator Replacement Projects (the "DCPP SG Replacement Projects" or "Projects"), involving the replacement of the four Unit 1 and four Unit 2 steam generators at its Diablo Canyon Power Plant ("DCPP"), all 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 Lawrence F. Womack 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 this 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.

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 105 and 363 of the Bankruptcy Code (11 U.S.C. §§105, 363)[1] authorizing PG&E to enter into contractual commitments for and incur multi-year capital expenditures not to exceed $706 million for the design, fabrication, delivery, and installation of replacement steam generators at its DCPP in support of the DCPP SG Replacement Projects. The up-to-$706 million in anticipated expenditures in connection with the Projects will be incurred over a five-plus year period, with a significant amount of such expenditures, estimated at $486 million, expected to be incurred in the final three years of the Projects, between 2007 and 2009.[2]

DCPP is a nuclear power plant located in San Luis Obispo County, California. The plant is the largest generating station on the PG&E electric system and provides power for over two million northern and central Californians from its two 1,100 megawatt units. The two units utilize eight steam generators ("SGs") to drive the turbine generators and

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

[2]PG&E by this Motion is seeking to incur multi-year capital expenditures not to exceed $706 million because, assuming the pending Plan of Reorganization dated July 31, 2003, as amended (the "Pending Plan"), is confirmed, PG&E does not anticipate that there will be an Effective Date until at least a few months into calendar year 2004. While it is true that (i) if the Pending Plan is confirmed and becomes effective by the spring of 2004 it is unlikely that PG&E would have expended more than a small fraction of the Projects cost prior to such Effective Date, and (ii) assuming the Plan is confirmed and becomes effective, PG&E as the Reorganized Debtor will no longer need Court authorization for these capital expenditures, PG&E is including the total Projects costs in the scope of this Motion for efficiency purposes, and out of an abundance of caution. In the unlikely event that a plan of reorganization is not confirmed and effective in 2004, PG&E will not have to return to Court and file another motion to incur expenditures necessary to continue implementation of Projects.

produce electricity. The SGs are large U-tube heat exchangers that convert heat into steam and are vital generation components. The tubing material used in the manufacturing of the SGs has been shown over the years to be susceptible to various forms of age-related degradation. In the mid-1990s, PG&E developed a steam generator strategic program in response to this tubing degradation. While this strategy has been successful in extending operational life, the SGs require replacement within the next five or six years in order to avoid forced outages and the premature shutdown of this critical generating resource.

PG&E brings this Motion because the requested $706 million exceeds the project limit authorized in PG&E's Motion for Authority to Make Capital Expenditures in the Ordinary Course of Business filed in this case on June 6, 2001, which was approved pursuant to the Court's Order thereon dated June 29, 2001 (such prior Motion and Order hereinafter are collectively referred to as the "Omnibus Cap Ex Motion and Order"). In broad outline, pursuant to the Omnibus Cap Ex Motion and Order, PG&E is authorized to proceed (a) without notice to or approval of the Court or the Official Committee of Unsecured Creditors (the "Committee"), with any project costing less than $10 million, (b) with notice to and no objection by the Committee, with any project costing more than $10 million and less than $50 million, and (c) only upon a motion noticed to the Committee and the United States Trustee on at least 10 business days' notice and approval of the Court, with any project anticipated to cost more than $50 million.

PG&E respectfully requests that this Motion be granted and that PG&E be permitted pursuant to Section 363 to expend up to $706 million to fund the DCPP SG Replacement Projects. PG&E further requests that it receive such approval forthwith to avoid the DCPP SG Replacement Projects from falling behind schedule. As was the case with PG&E's motions for authority to incur capital expenditures in connection with its Path 15 Project and Tri-Valley Project (which were granted by separate orders issued by the Court on February 8, 2002), PG&E by the present Motion is not asking the Court to address or rule on any state law regulatory issues; rather, PG&E by this Motion only seeks authorization to incur the subject capital expenditures pursuant to Section 363 of the

Bankruptcy Code.

II.

FACTUAL BACKGROUND[3]

A. <u>The DCPP SG Replacement Projects</u>.

The two units at DCPP each have four steam generators which are large U-tube heat exchangers that convert heat carried by the coolant that passes through the reactor vessel into steam to drive the turbine generators and produce electricity. The SGs are approaching the end of their useful life.

PG&E has had a SGs management program since before DCPP commenced operation and, over the years, all industry-recommended programs have been promptly implemented. In the mid-1990s, PG&E developed a strategic plan focused on managing SGs degradation in order to extend the operational life of the SGs. This strategy has been successful in delaying the need for the replacement of the SGs, and together with a program of increased SG inspections, tube sleeving and other remedial actions, PG&E is confident that both DCPP units can continue to operate safely and reliably with the existing SGs until the planned 2008/2009 replacement. Confidence in uninterrupted operations decreases rapidly however if replacement is delayed beyond the current replacement plan.

The Projects implement managed replacement rather than risking expedited replacement at additional cost in reaction to unanticipated rapid degradation. Currently, almost all operating nuclear units in the United States employing SGs made from the same tubing material have replaced the original SGs or are actively working on replacement projects.

[3]The evidentiary basis and support for the facts set forth in this Motion are contained in the Declaration of Lawrence F. Womack filed concurrently herewith.

B. DCPP SG Replacement Projects Cost.

On December 17, 2003, PG&E's Board of Directors approved capital expenditures in the aggregate amount not to exceed $706 million, subject to Bankruptcy Court approval, for the DCPP SGs Replacement Projects. This expenditure level is expected to cover the anticipated work supporting the Projects.

The DCPP SGs Replacement Projects are the lowest cost alternative in addition to being the only viable scenario. While other delayed replacement alternatives were considered, they resulted in substantially increased risk of forced outage, increased maintenance cost, increased risk of early forced shutdown, and higher project costs. The only alternative to the replacement of the SGs is continued operation with the old SGs, which virtually assures early shutdown of DCPP before the expiration of the current operating license in 2021 for Unit 1 and in 2025 for Unit 2. The estimated total Projects cost, including escalation, overheads, AFUDC, and related contingencies, is $706 million and is based on a feasibility study performed by a major engineering firm that provides SG replacement services as well as benchmarking of SG replacement projects at other utilities. Two specialized consulting firms were also used to provide independent cost estimates. The estimated Projects cost is considered to provide high confidence that planned costs will not be exceeded.[4] Generally speaking, the Projects cost is expected to be included in PG&E's cost-of-service ratemaking, subject to approval of the California Public Utility Commission ("CPUC") as discussed below.

C. The CPUC Approval For The DCPP SG Replacement Projects.

The approval of the CPUC is required for the rate base addition resulting from the

[4]The current DCPP decommissioning cost estimate covers the dismantlement of the eight SGs installed in Units 1 and 2. The proposed Projects will result in the addition of a second set of SGs for disposal. The decommissioning cost estimate will be revised, as necessary, to include the off-site disposal of eight additional SGs. In future CPUC proceedings, PG&E will request additional funds through customer rates, if necessary, to ensure the continued adequacy of the nuclear decommissioning trusts.

DCPP SG Replacement Projects. A special ratemaking application to the CPUC will be necessary based on the proposed 2003-2006 Generation General Rate Case settlement. The CPUC application process normally requires twelve to eighteen months. In order to meet the schedule for the first unit replacement, a contract must be awarded for construction of new SGs by June 2004. Therefore, the application will request that the CPUC issue an interim decision authorizing PG&E to enter into long lead-time component contracts in June 2004 and, in the event that the Projects are not ultimately approved by the CPUC, authorization to fully recover expenditures to the point of decision and any cancellation charges in rates.

III.

THE DCPP SG REPLACEMENT PROJECTS SHOULD BE AUTHORIZED PURSUANT TO SECTIONS 105 AND 363 OF THE BANKRUPTCY CODE.

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

The DCPP SG Replacement Projects have elements of all three expenditure categories, in that the completion of the Projects will help avoid emergency shortages resulting from forced outages and improve the long-term reliability of electrical generation

in California. In addition, the Projects will insure compliance with the strict regulatory requirements of the Nuclear Regulatory Commission.

As previously noted in the Cap Ex Omnibus Motion, PG&E believes that the expenditures on virtually all of its capital projects as described above are within the ordinary course of its business. As such, PG&E appreciates that such expenditures should be permitted without notice or hearing or any Bankruptcy Court approval pursuant to 11 U.S.C. §363(c) as a use, sale or lease of estate property in the ordinary course of business. However, recognizing that few are the cases in which a debtor in possession must make well over $1 billion in capital expenditures per year due to the unique nature of its business and the complex regulatory environment in which it operates, PG&E already has agreed that the Committee and the Court should be apprised of and/or asked to approve PG&E's capital expenditures at certain substantial materiality thresholds as established in the Omnibus Cap Ex Motion and Order. See generally Omnibus Cap Ex Motion at 15:23-17:20. Thus, although the DCPP SG Replacement Projects were conceived and will be undertaken in the ordinary course of PG&E's business, PG&E seeks this Court's authority to proceed with the Projects because the anticipated cost of the Projects exceeds $50 million, and a motion and Court approval therefore are required pursuant to the Omnibus Cap Ex Motion and Order.

PG&E has demonstrated in Part II above that the Projects are important to the reliability of DCPP and its continued operation through the license period, and that the proposed maximum $706 million expenditure for the Projects is the most cost-efficient and least-risk method to implement and attain the completion of the Projects. Accordingly, this Court plainly can and should utilize its authority under Section 363 of the Bankruptcy Code to approve the capital expenditure authorization for the DCPP SG Replacement Projects requested by the Motion.

Additionally, Section 105(a) of the Bankruptcy Code authorizes this Court to "issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title." The purpose of Section 105 is "to assure the bankruptcy courts' power to take whatever action is appropriate or necessary in aid of the exercise of their

jurisdiction." 2 L. King, *Collier on Bankruptcy* ¶105.01, at 105-6 (15th ed. rev. 2000). For the reasons set forth above, the capital expenditures authorization for the DCPP SG Replacement Projects requested by this Motion plainly will best serve the interests of the Debtor, its creditors and its customers alike, and will not violate any principle or precept of the Bankruptcy Code. Accordingly, pursuant to the Court's authority and discretion under Section 105(a) of the Bankruptcy Code, the Court can and should grant the Motion.

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 multi-year expenditure of funds not to exceed $706 million to implement and complete the DCPP SG Replacement Projects.

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DATED: December 17, 2003.

Respectfully,

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