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UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF CALIFORNIA

In re) Bankruptcy Case
PACIFIC GAS AND ELECTRIC COMPANY,) No. 01-30923DM
a California corporation,) Chapter 11
Debtor.)

**AMENDED MEMORANDUM DECISION APPROVING SETTLEMENT AGREEMENT
AND OVERRULING OBJECTIONS TO CONFIRMATION OF
REORGANIZATION PLAN**

On December 12, 2003, the court issued a memorandum decision approving a settlement agreement (the "PSA") among debtor Pacific Gas and Electric Company ("PG&E"), a solvent utility, its parent PG&E Corporation ("Parent"), and the California Public Utilities Commission ("Commission") and overruling objections to the confirmation of the reorganization plan proposed by PG&E, Parent and the Official Committee of Unsecured Creditors ("OCC", and collectively with PG&E and Parent, the "Plan Proponents"). On December 18, 2003, the Commission approved the PSA, but with certain modifications.¹ Therefore, the court is revising its

¹ The Commission's approval is set forth in its Decision 03-12-035, Opinion Modifying The Proposed Settlement Agreement Of Pacific Gas & Electric Company, PG&E Corporation And The Commission Staff, And Approving The Modified Settlement Agreement

1 memorandum decision to reflect that, for the reasons set forth in
2 its original memorandum decision, it approves the revised
3 settlement agreement executed by PG&E, Commission, and Parent on
4 December 19, 2003 (the "Settlement Agreement"). Moreover, the
5 court has approved, and by separate order entered December 22,
6 2003 (the "Confirmation Order") has confirmed, the plan of
7 reorganization dated July 31, 2003, as modified by modifications
8 dated November 6, 2003 and December 19, 2003 (the "Plan").

9
10 **I. INTRODUCTION**

11 The Plan proposed by Plan Proponents will permit PG&E to
12 begin its exit from a two and one-half year bankruptcy case and
13 pay or reinstate billions of dollars in debt as soon as the plan
14 becomes effective. The court must be satisfied that the Plan
15 complies with applicable provisions of the Bankruptcy Code and is
16 consistent with the goals of reorganization under chapter 11.

17 A centerpiece of the Plan, crucial to its success, is the
18 Settlement Agreement. In approving the Settlement Agreement, the
19 Commission considered the interests of ratepayers, customers,
20 PG&E, its shareholders and the public in general and decided that
21 the agreement is appropriate as a matter of California public
22 utility policy. The Commission made a business judgment on the
23 propriety of substantive provisions of the Settlement Agreement,
24 such as whether those provisions were too burdensome for
25 ratepayers and too generous for PG&E; whether they were
26 appropriate to relieve PG&E from its financial crisis; whether any
27 particular terms or provisions of the PSA should be modified as
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 (the "December 18 Decision").

1 reflected in the Settlement Agreement; and whether there were
2 acceptable alternatives.

3 Both this court and the Commission have similar, but not
4 identical, tasks. Where those tasks coincide is the duty of each
5 to determine that the execution and performance of the Settlement
6 Agreement will be lawful.

7 This court's duty, derived from section 1129(a)(3),² is to be
8 certain that the Settlement Agreement and the Plan's
9 implementation of it comply with applicable law. It will also
10 assure that nothing in the Settlement Agreement undermines the
11 feasibility of the Plan. 11 U.S.C. § 1129(a)(11). The court
12 remains mindful that the Ninth Circuit has made clear that:

13 . . . as a matter of federal law, state officials cannot
14 enter into a federally sanctioned consent decree beyond their
authority under state law . . .

15 Southern California Edison Co. v. Lynch, 307 F.3d 794, 809 (9th
16 Cir. 2002), quoted in Southern California Edison Co. v. Peevey, 31
17 Cal.4th 781, 787 (2003).³

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25 ² Unless otherwise indicated, all section and rule
26 references are to the Bankruptcy Code, 11 U.S.C. §§ 101-1330 and
the Federal Rules of Bankruptcy Procedure, Rules 1001-9036.

27 ³ While the Commission is not a proponent of the Plan, the
28 Settlement Agreement's paragraphs 20, 21 & 22 commit the
Commission before this court just as much as a traditional federal
court consent decree.

1 **II. BACKGROUND**⁴

2 On April 19, 2002, PG&E and Parent as co-proponents proposed
3 a chapter 11 plan of reorganization. That plan, amended from time
4 to time (the "Original Plan"), provided for the disaggregation of
5 PG&E's historic businesses into four separate entities. Three of
6 those new business entities (electric generation, electric
7 transmission and gas transmission) would have been regulated by
8 the Federal Energy Regulatory Commission, free from decades of
9 regulation by the Commission. The Commission would continue to
10 regulate any electric distribution and sale by the surviving
11 utility.

12 The Commission vigorously opposed the Original Plan virtually
13 every step of the way (see Pacific Gas and Elec. Co. v.
14 California, 350 F.3d 932 (9th Cir. 2003) and it
15 filed a competing plan, which was subsequently joined by the OCC
16 (the "Joint Plan").

17 On November 18, 2002, the court began hearings on
18 confirmation of the competing plans. After the Commission and the
19 OCC rested their case-in-chief in connection with the Joint Plan,
20 the court heard and denied a motion by PG&E and Parent under Rule
21 7052(c) to deny confirmation of the Joint Plan. The motion was
22 denied, in part, because the court concluded that a proposed

23
24 ⁴ The discussion in this amended memorandum decision
25 constitutes the courts findings of fact and conclusions of law
26 (Rule 7052(a)) in addition to those set forth in its "Findings of
27 Fact In Support of Plan of Reorganization Under Chapter 11 of the
28 Bankruptcy Code for Pacific Gas and Electric Company Dated July
31,2003, As Modified By Modifications Dated November 6, 2003, and
December 19, 2003" and its "Conclusions of Law Required By the
Plan of Reorganization Under Chapter 11 of the Bankruptcy Code for
Pacific Gas and Electric Company" entered this date.

1 Reorganization Agreement, discussed infra, was lawful. Trial on
2 the Original Plan continued, but during that trial, on March 4,
3 2003, the court ordered a judicially supervised settlement
4 conference. Shortly thereafter it stayed all proceedings on the
5 Original Plan and the Joint Plan. PG&E, Parent, the OCC and the
6 Commission, through its staff, then participated in a confidential
7 settlement conference before Hon. Randall J. Newsome, United
8 States Bankruptcy Judge. On June 19, 2003, Judge Newsome,
9 accompanied by Plan Proponents and the Commission staff,
10 announced a proposed settlement.⁵

11 On July 31, 2003, the Plan Proponents filed the Plan, which
12 was thereafter amended from time to time by various modifications.
13 After the court approved the disclosure statement accompanying the
14 Plan, the Plan Proponents solicited the votes of impaired classes
15 of creditors. All impaired classes but one accepted the Plan.

16 Various parties filed objections to confirmation; by the
17 conclusion of the confirmation trial, all objections had been
18 resolved other than those filed by the City of Santa Clara ("Santa
19 Clara"), the Merced Irrigation District ("MID"), the City of Palo
20 Alto ("Palo Alto") and the Northern California Power Agency
21 (collectively with Santa Clara and MID, the "Municipal
22 Objectors"); the Attorney General of the State of California on
23 behalf of various state agencies (the "AG"); and the City and
24 County of San Francisco ("CCSF," and collectively with the
25 Municipal Objectors and the AG, the "Objectors").

26
27 ⁵ The court extends its sincere appreciation to Judge
28 Newsome for his tireless and unselfish efforts in attempting to
bring about a resolution to this long and complex case.

1 Trial on confirmation of the Plan began on November 10, 2003,
2 and after closing arguments for and against confirmation and for
3 and against admission of various documentary evidence were made on
4 November 24, and November 25, 2003, the court took the matter
5 under submission.⁶

6 Objectors' primary objections are directed at (1) the
7 legality and enforceability of the Settlement Agreement, relying
8 on section 1129(a)(3) ("[T]he plan has been proposed in good faith
9 and not by any means forbidden by law") and section 1129(a)(11),
10 commonly referred to as the "feasibility" requirement, and (2) the
11 extent and effect of releases to be given under the Plan, relying
12 on section 524(e) (" . . . discharge of a debt of the debtor does
13 not affect the liability of any other entity . . ."). Objectors
14 have also raised numerous other challenges to confirmation. These
15 include: other subsections of section 1129(a) have been violated;
16 there is an indefinite gap between the entry of a Confirmation
17 Order and the likely Effective Date; Debtor has not justified the

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19 ⁶ By separate order issued December 12, 2003, the court has
20 sustained PG&E's objections to the admission of Municipal
21 Objectors' exhibits 216, 217 and 218, respectively the
22 Administrative Law Judge's tentative decision disapproving the
23 Settlement Agreement and Commissioner Peevey's two alternate
24 proposed Commission decisions. It also sustained PG&E's post-
25 trial objections to AG's and Municipal Objectors' post-trial
26 tender of three newly issued alternate proposed decisions issued
27 by Commissioners Lynch, Wood and Brown. Assuming those documents
28 would survive PG&E's hearsay objections, the court is satisfied
that they are not relevant to the task before it, and while the
court respects the efforts of Administrative Law Judge Barnett and
the four Commissioners, their own views are irrelevant to this
court's independent decision. For these same reasons, during a
status conference on December 22, 2003, the court rejected the
proffer by Palo Alto of the dissenting opinions to the December 18
Decision filed by two Commission members.

By the order issued on December 12, 2003, the court also
sustained PG&E's objections to the admission of Municipal
Objectors' exhibit 219 as irrelevant.

1 release it will give to Parent; claims of creditors who are not
2 paid as of the Effective Date are treated unfairly as a result of
3 the financing, perhaps secured by PG&E's assets, that will be put
4 in place on the Effective Date; property interests of Santa Clara
5 have not been protected; approval of a Stipulation Resolving
6 Issues Regarding the Land Conservation Commitments is needed; and
7 the Commission's waiver of sovereign immunity is overly broad.
8 This court overrules all objections to confirmation of the plan
9 and challenges to the Settlement Agreement, as all of the
10 applicable requirements of section 1129(a) have been satisfied.
11 Section 1129(b) has also been satisfied as to the one impaired
12 class of creditors that did not vote.

13 The court will limit this Memorandum Decision to an
14 explanation of its reasons for overruling Objectors' principal
15 objections.⁷

17 ⁷ The court briefly itemizes its conclusions on the other
18 objections. The Plan is "feasible" as that term has been used to
19 refer to the requirements of section 1129(a)(11). This court can
20 and will control any risks arising from any extension of the March
21 31, 2004, deadline by which the Plan's Effective Date must occur;
22 the waiver of sovereign immunity in the Settlement Agreement and
23 support for the Plan is limited to the Commission and does not
24 extend to other California agencies; Santa Clara's property
25 interests have been protected by appropriate language in the
26 Confirmation Order; and the stipulation regarding environmental
27 matters has been approved. To satisfy some of the AG's concerns,
28 the court has included in paragraph 22 of the Confirmation Order
that approval the release PG&E is giving Parent "does not amount
to an adjudication of the underlying merits of the claims being
released." For this reason the court denies as moot AG's motion
in limine regarding testimony about the claims being released.

The United States Trustee claims that PG&E's contemplated
reimbursement of Commission's professional fees, as agreed in the
Settlement Agreement, are improper without court review pursuant
to sections 503(b) or 330. Review and ultimate allowance of those
fees will be dealt with by separate order. The provisions of the
PSA calling for PG&E to reimburse Parent's professional fees were

1 **III. THE SETTLEMENT AGREEMENT**

2 The following is a summary of key provisions of the
3 Settlement Agreement:

4 Statement Of Intent

5 The parties recite the importance of reliable electric and
6 gas service as being of the utmost importance to the safety,
7 health and welfare of California's citizenry and economy and
8 expect that the Plan will result in reduction of certain electric
9 rates after January 1, 2004. PG&E will continue to be regulated
10 by the Commission. The intent of the Settlement Agreement is to
11 enable PG&E to emerge from chapter 11 and resume fully its
12 traditional role of providing safe and reliable electric and gas
13 service at just and reasonable rates, subject to Commission
14 regulation. The parties intend that PG&E emerge from chapter 11
15 with a company credit rating of Investment Grade, which rating is
16 to improve over time and which will directly benefit PG&E's
17 ratepayers by reducing the cost of financing to emerge from
18 chapter 11 and to fund future operations.⁸

19 Regulatory Asset

20 The Settlement Agreement provides that the Commission shall
21 establish a Regulatory Asset of \$2,210,000,000 as a new, separate
22 and additional part of PG&E's rate base. This Regulatory Asset
23 will be amortized in PG&E's electrical rates over nine years. The

24 _____
25 disapproved by the Commission in the December 18 Decision and have
26 been deleted from the Settlement Agreement and the Plan.

27 ⁸ The evidence at trial on the Plan established that if the
28 Plan becomes effective, PG&E will likely obtain an Investment
Grade rating and thus likely be able to raise approximately \$8.7
billion to fund the Plan and pay or reinstate debts and preferred
stock interests exceeding \$12 billion on the Effective Date.

1 Regulatory Asset shall earn PG&E's authorized return on equity
2 ("ROE") on the equity component of its capital structure as set
3 forth in its annual cost of capital proceedings, provided that the
4 ROE shall be no less than 11.22% per year for the life of the
5 Regulatory Asset. Once the equity component of PG&E's capital
6 structure reaches 52%, the authorized equity component of the
7 Regulatory Asset shall be no less than 52% for the life of the
8 Regulatory Asset. The outstanding balance of the Regulatory Asset
9 will be reduced to the extent any net after-tax amount of refunds,
10 claim offsets and other credits are available to PG&E from
11 generators and other energy suppliers.⁹

12 PG&E's utility retained generation rate base already
13 established in prior Commission proceedings shall be deemed just
14 and reasonable and not subject to modification, adjustment or
15 reduction (with certain exceptions) and the Commission will not
16 reduce or impair the value of the Regulatory Asset or that utility
17 retained generation rate base by taking the Regulatory Asset or
18 that rate base, their amortization or earnings into account when
19 setting other revenue requirements and resulting rates. The
20 Commission will also not take into account the Settlement
21 Agreement or the Regulatory Asset in establishing PG&E's
22 authorized ROE or its capital structure.

23 The Commission acknowledges the importance of Investment
24 Grade credit ratings for PG&E to function and it acknowledges that
25 such a credit rating directly benefits PG&E's ratepayers by

26
27 ⁹ Appendix A to the Settlement Agreement indicates that over
28 the nine-year term of the Settlement Agreement, in excess of \$5
billion will have to be collected in rates to retire the
Regulatory Asset.

1 reducing its immediate and future borrowing costs, which in turn
2 will permit PG&E to finance its operations and make capital
3 expenditures in the future at lower costs to its ratepayers. In
4 furtherance of those objectives, the Commission agrees ". . . to
5 act to facilitate and maintain Investment Grade company ratings
6 for PG&E."

7 The Commission also agrees to act in a timely manner on
8 PG&E's applications to collect in rates its prudently incurred
9 costs of any new, reasonable investment utility plant and assets.
10 Further, the Commission agrees that, absent "compelling evidence
11 to the contrary, PG&E's expected regulatory outcomes and financial
12 performance should be similar to those of the other investor-owned
13 utilities in California under similar circumstances." The
14 Commission agrees not to discriminate against PG&E by reason of
15 its chapter 11 case, litigation filed by PG&E against the
16 Commission to recover past lost revenues, the Settlement
17 Agreement, the Regulatory Asset or other matters addressed or
18 resolved therein.

19 Ratemaking Matters

20 The Commission agrees to maintain electrical rates at current
21 levels through December 31, 2003, and may thereafter adjust
22 electric rates consistent with the Settlement Agreement, the Plan,
23 the Confirmation Order and California law. The Commission also
24 agrees to set PG&E's capital structure and authorized ROE in the
25 usual manner, except that beginning January 1, 2004, and
26 continuing until either Standard & Poor's confers a credit rating
27 of "A-" or Moody's confers a credit rating of at least "A3," the
28 authorized ROE shall be no less than 11.22% per year and the

1 authorized equity ratio for ratemaking purposes shall be no less
2 than 52%, except for a transition period described in the
3 Settlement Agreement.

4 Headroom

5 Certain net income accrued or collected through and including
6 December 31, 2003, is agreed to be property of PG&E's chapter 11
7 estate; provided, however, headroom (defined in the Settlement
8 Agreement) revenues accrued during calendar year 2003 shall not
9 exceed \$875 million or be less than \$775 million. If headroom
10 exceeds \$875 million, the Commission will take necessary action to
11 refund such excesses; if it is less than \$775 million, the
12 Commission will permit PG&E to collect the shortage in rates.

13 Dismissal Of Litigation

14 PG&E agrees to dismiss pending rate recovery litigation,¹⁰
15 foregoing any recovery from ratepayers of costs sought in that
16 litigation not otherwise provided for in the Settlement Agreement.
17 It also agrees to withdraw the Original Plan, dismiss various
18 other actions related to that plan and abandon its efforts to
19 disaggregate.

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24 ¹⁰ The principal action PG&E will dismiss is based on the
25 federal filed-rate doctrine now pending in the United States
26 District Court for the Northern District of California. The
27 theory of the action is that PG&E should be allowed, as a matter
28 of federal law, to recover the excess of wholesale electricity
costs incurred during the energy crisis over retail electricity
sales during that period. While the Commission denies liability,
PG&E contends that it could recover several billion dollars in
future rates were it to prevail.

1 Waiver Of Sovereign Immunity

2 The Commission "knowingly and expressly" waives all existing
3 and future rights of sovereign immunity, and all other similar
4 immunities, as a defense in any action or proceeding concerning
5 enforcement of the Settlement Agreement. It also consents to
6 jurisdiction of "any court or other tribunal or forum for such
7 actions or proceedings, including but not limited to, this court."
8 While the AG contends the waiver of sovereign immunity improperly
9 extends to other state agencies, the court construes the
10 provisions of the Settlement Agreement and the Plan pertaining to
11 a waiver of sovereign immunity to extend only to the Commission.¹¹

12 Validity and Binding Effect

13 The Settlement Agreement provides that it will be
14 "irrevocable and binding" upon the parties and their successors
15 and assigns, "notwithstanding any future decisions and orders of
16 the Commission." The parties also agree that this court shall
17 retain jurisdiction over them for all purposes relating to the
18 enforcement of the Settlement Agreement, Plan and the Confirmation
19 Order. Due to the inadequacy of money damages the parties have
20 agreed to specific performance by way of injunctive or other
21 equitable relief to remedy any breach. Further, the Settlement
22 Agreement is not intended, whether expressly or by implication, to
23 confer any rights or remedies on anyone other than the parties

24
25 ¹¹ Counsel for PG&E contends that the AG and other agencies
26 of the state of California have waived sovereign immunity by their
27 conduct during this case. He concedes, however, that nothing in
28 the Settlement Agreement or the Plan is specifically intended to
constitute such a waiver. Based upon those representations and
its own review of the Plan and the Settlement Agreement, the court
concludes that the waiver of sovereign immunity that will become
effective under the Plan applies only to the Commission.

1 thereto.

2 Term of Settlement Agreement

3 The Settlement Agreement terminates nine years after the
4 Plan's Effective Date, although vested rights survive and may be
5 enforced after termination.

6 **IV. RELEASE PROVISIONS OF PLAN**

7 Sections 11.4 through 11.6 of the Plan provide for various
8 releases, many of which are required by Paragraph 24 of the
9 Settlement Agreement. The Plan Proponents release each other and
10 their employees and advisors, among others. Debtor (as debtor-in-
11 possession and as Reorganized Debtor) releases a broad class of
12 persons called "Releasees" from "any and all Causes of Action held
13 by, assertable on behalf of the Debtor or derivative of the
14 Debtor's rights, in any way relating to the Debtor, the Debtor-in-
15 Possession, the Chapter 11 Case, the Plan, negotiations regarding
16 or concerning the Plan, and the ownership, management and
17 operation of the Debtor and Debtor-in-Possession . . ." The term
18 "Releasees" is defined to include the OCC, the Parent, and people
19 who are, on or after the petition date, their and Debtor's
20 officers, directors, members of management, or members, and all of
21 their advisors, consultants or professionals.

22 **V. ISSUES**

23 A. Will the Settlement Agreement be legal and enforceable
24 when fully executed and approved by the Commission and
25 this court?¹²

26 ¹² While the court resolved both aspects of this issue as to
27 the PSA (legal and enforceable and did not delegate ratemaking
28 authority), the court revisits the issue in light of the
Commission's modifications to the PSA and approval of the
Settlement Agreement in the December 18 Decision. While neither

1 B. Has PG&E justified its release of Parent, and do other
2 releases in the Settlement Agreement and Plan violate
3 the law?

4 **VI. DISCUSSION**

5 **A. The Settlement Agreement is Legal and Enforceable.**

6 As noted previously, the Plan and Settlement Agreement are
7 the results of months of judicially-supervised settlement
8 negotiations among PG&E, Parent, the Commission staff and the OCC.
9 The Settlement Agreement resolves the competing plans of
10 reorganization and ends lengthy and costly litigation between PG&E
11 and the Commission relating to the energy crisis. Under the
12 Settlement Agreement, PG&E shall emerge from chapter 11 as a
13 vertically integrated utility subject to the traditional
14 ratemaking jurisdiction of the Commission, just as it has been for
15 nearly a century.

16 Objectors contend that the Plan is unconfirmable because it
17 has been proposed by means forbidden by law (11 U.S.C.
18 § 1129(a)(3)), in that future commissions allegedly cannot be
19 bound by the terms of the Settlement Agreement and the Settlement
20 Agreement allegedly constitutes improper ratemaking. As explained
21 below, the court disagrees with the Objectors.¹³

22 _____
23 the court's decision nor the Commission's decision is dependent or
24 conditioned upon the other's, that both have reached the same
conclusion reinforces the propriety of that result.

25 ¹³ Nor is the court persuaded by Objectors' arguments
26 regarding the lack of good faith required by section 1129(a)(3).
27 The Ninth Circuit has held that a plan is proposed in good faith
28 if it is designed to facilitate the purposes of the Bankruptcy
Code -- purposes which include facilitating the successful
rehabilitation of debtor and maximizing the value of the
bankruptcy estate. Security Farms v. General Teamsters etc. (In
re General Teamsters etc.), 265 F.3d 869 (9th Cir. 2001). A plan

1 1. The Commission Is Authorized to Enter Into the
2 Settlement Agreement.

3 a. Constitutional and Statutory Authority

4 The Commission has the inherent authority under California
5 Public Utilities Code section 701¹⁴ to enter into binding
6 contracts. This power arises from the Commission's broad
7 constitutional and statutory authority to regulate public
8 utilities. See Cal. Const., art. XII, §§ 5 & 6; Cal. Pub. Util.
9 Code §§ 451, 701, 761, 762; Wood v. Public Utilities Comm'n, 4
10 Cal.3d 288, 294-95 (1971). Specifically, section 701 provides
11 that the Commission, in its supervision and regulation of public
12 utilities, "may do all things, whether specifically designated in
13 this part or in addition thereto, which are necessary and

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15 has not been proposed with a lack of good faith merely because
16 opponents question the legality of some of its terms. If those
17 terms are found to be unlawful, confirmation will be denied for
18 that reason and not based upon lack of good faith without other
19 supporting evidence.

20 The Ninth Circuit has also ruled that a solvent debtor's use
21 of bankruptcy to avoid paying a default rate of interest is not
22 necessarily a lack of good faith. Platinum Capital, Inc. v.
23 Sylmar Plaza, LP (In re Sylmar Plaza, LP), 314 F.3d 1070 (9th Cir.
24 2002), cert. denied, ___ U.S. ___, 123 S.Ct. 2097 (2003).

25 The court is convinced that the Settlement Agreement is
26 intended to facilitate the successful reorganization of PG&E and
27 to maximize the value of the bankruptcy estate by settling
28 protracted, expensive and uncertain litigation, including this
very hard fought Chapter 11 case. Although PG&E is solvent, the
pendency of this litigation is delaying payment of creditors and
increasing PG&E's cost of borrowing to the detriment of all
parties. Further, the Commission's approval of the Settlement
Agreement in the December 18 Decision confirms the good faith of
the Plan Proponents and of the Plan. Therefore, the court rejects
the Objectors' arguments as to lack of good faith.

14 This section of the Memorandum Decision discusses various
provisions of the California Public Utilities Code, specifically
sections 451, 701, 728, 761, 762, 816, 817, and 1708. These
sections shall be referred to simply as "section ____." Other
section references continue to refer to the Bankruptcy Code.

1 convenient in the exercise of such power and jurisdiction." Cal.
2 Pub. Util. Code § 701. See also U.S. Ecology, Inc. v. State of
3 California, 92 Cal.App.4th 113, 132 (2001) ("Administrative
4 officials may exercise such additional powers as are necessary for
5 the due and efficient administration of powers expressly granted
6 by statute, or as may fairly be implied from the statute granting
7 the powers. Thus, an administrative agency has the power to
8 contract on a particular matter if this power may be fairly
9 implied from the general statutory scheme.").

10 In addition to section 701, the Commission is empowered under
11 other sections to make the commitments proposed in the Settlement
12 Agreement. For example, section 816 authorizes the issuance of
13 securities; section 817 specifically authorizes issuance of
14 securities in a recapitalization or reorganization; and section
15 451 authorizes the Commission to permit PG&E to recoup the costs
16 of securities as well as the reasonable ongoing cost of providing
17 electric and gas services. Thus, the commitments in the
18 Settlement Agreement are consistent with the Commission's
19 regulatory obligations.

20 The Objectors contend that section 1708 and section 728
21 change this analysis. Section 1708 authorizes the Commission to
22 rescind or alter its previous decisions and orders and section 728
23 authorizes the Commission to change a utility's rates if it
24 determines current rates are no longer just or reasonable. As
25 discussed in more detail below, the Settlement Agreement is a
26 contract and a settlement of litigation by the Commission, not an
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1 opinion or order of the Commission subject to section 1708.¹⁵
2 Moreover, the Settlement Agreement addresses only discrete
3 components from which future revenue requirements will be based
4 but it does not set rates and therefore does not implicate section
5 728.

6 b. Case Law

7 The California Supreme Court has recently confirmed in
8 Southern California Edison Co. v. Peevey, 31 Cal.4th 781 (2003),
9 that the Commission may enter into a binding agreement which
10 compromises disputes and has prospective effects on rates.
11 Recognizing the broad statutory powers of the Commission, the
12 Supreme Court stated:

13 Statutorily, [the Commission] is authorized to supervise and
14 regulate public utilities and to "do all things . . . which
15 are necessary and convenient in the exercise of such power
16 and jurisdiction" (§ 701); this includes the authority to
17 determine and fix "just, reasonable (and) sufficient rates"
18 (§ 728) to be charged by the utilities. Adverting to these
19 provisions, we have described [the Commission] as "a state
20 agency of constitutional origin with far-reaching duties,
21 function and powers" whose "power to fix rates [and]
22 establish rules has been liberally construed."

23 Id. at 792 (citations and some internal quotation marks omitted).

24 In Southern California Edison, Southern California Edison
25 ("SCE") brought a federal suit against the Commission claiming
26 that the Commission's regulation of electricity rates violated
27 federal law in several respects. Id. at 786. The parties
28 subsequently entered into a settlement agreement which became the
basis for a stipulated judgment. Id. The Utility Reform Network

26 ¹⁵ This court specifically rejects MID's suggestion that the
27 fact that a Commission order is the device for obtaining approval
28 of the Settlement Agreement somehow transforms the Settlement
Agreement into the equivalent of an order of the Commission.

1 ("TURN") objected that the stipulated judgment violated California
2 state law.¹⁶ In its settlement agreement with SCE, the Commission
3 agreed to allow SCE to recover certain costs by maintaining the
4 existing rates for a set period of time. Id. at 799-800. Like
5 the current Settlement Agreement, the compromise agreement was
6 "intended to . . . restore SCE's creditworthiness and avoid
7 further instability and uncertainty for the company and
8 consumers." Id. at 800.

9 Recognizing that the Commission's broad discretion included
10 future ratemaking, the California Supreme Court held that the
11 Commission had the authority under state law to freeze rates for a
12 certain period of time. Id. at 803. Thus, the court has
13 acknowledged that the broad authority of section 701 includes the
14 authority to enter into binding contracts, including contracts
15 that constrain the Commission's future conduct in order to
16 effectuate the Commission's regulatory mission.

17 In finding that the Commission had the inherent authority to
18 enter into a rate settlement agreement with SCE, the California
19 Supreme Court stated:

20 If [the Commission] lacked substantive authority to
21 propose and enter into the rate settlement agreement at
22 issue here, it was not for lack of inherent authority,
23 but because this rate agreement was barred by some
24 specific statutory limit on [the Commission's] power to
25 set rates.

26 Id. Even though TURN argued that the rate agreement violated
27 specific statutes, the court disagreed and held that no "specific
28 statutory limit" barred the rate agreement.

27 ¹⁶ The case reached the California Supreme Court after the
28 Ninth Circuit Court certified three state law questions to it.
See Southern California Edison Co. v. Lynch, 307 F.3d at 809.

1 In other words, there is nothing in the law of California
2 that prohibits the Commission from being a party to an agreement
3 that settles existing litigation and supports a utility's
4 reorganization on terms that are binding on future Commissions.
5 Id.; Rich Vision Centers Inc. v. Bd. of Med. Exam'rs, 144
6 Cal.App.3d 110, 117 (1983) (holding that "we discern no reason in
7 logic, law or policy to deny to the Board as a state agency acting
8 on behalf of the state citizenry, or to its attorneys, the same
9 options to settle cases on any legitimate terms as are available
10 to private litigants and their attorneys"). This concept is not
11 surprising. The Commission has the unquestioned power to appear
12 in court, enter into contracts, fix rates and do many other
13 things. Given these powers, it would be startling (and a severe
14 handicap) if the Commission were prohibited from settling lawsuits
15 by a consent decree or settlement agreement. Therefore, the court
16 is satisfied that the Commission has authority to settle its
17 disputes with PG&E and the Parent.¹⁷

18

19 ¹⁷ The court is not troubled that the Settlement Agreement
20 obligates future commissions to include the Regulatory Asset in
21 PG&E's rate base and to amortize it as a component of future
22 revenue requirements over the life of that agreement. Nor is this
23 court troubled that the ROE and the equity ratio will be frozen
temporarily, until PG&E has achieved certain credit ratings. The
form of settlement is different from what was authorized in
Southern California Edison but the substance is not.

24 In Southern California Edison, the schedule of payments to
25 SCE depended on the amount of a surplus (the difference between
26 rates set by future commissions and the rate freeze). Under the
27 Settlement Agreement, the payments to PG&E depend on how quickly
PG&E returns to certain credit ratings and on the requirement to
amortize the Regulatory Asset. The only essential difference is
the amount of payment.

28 Various parties have referred to the schedule of payments on
the Regulatory Asset as a mortgage-style amortization. Applying

1 In fact, the ability of the Commission to enter into binding
2 contracts is an important attribute of the Commission's power. As
3 recognized in Santa Margarita Area Residents Together v. San Luis
4 Obispo County Board of Supervisors, 84 Cal.App.4th 221 (2000), a
5 governmental agency has authority to enter into an enforceable
6 agreement. In Santa Margarita, San Luis Obispo County and a real
7 estate developer entered into a development agreement. The
8 plaintiffs sued to set aside the agreement, contending that the
9 zoning freeze in the agreement unconstitutionally contracted away
10 the county's police power. The court disagreed:

11 A governmental entity did not contract away its police power
12 unless the contract amounts to the "surrender" or
13 "abnegation" of a proper governmental function. . . . [¶]
14 The county concluded that the zoning freeze in the Agreement
15 advances the public interest by preserving future options.
This type of action by the County is more accurately
described as a legitimate exercise of governmental police
power and the public interest than as a surrender of police
power to a special interest.

16 Id. at 233 (emphasis added) (citations omitted). In addition, the
17

18 that analogy, the Commission staff and PG&E have essentially
19 agreed to "principal" of \$2.21 billion staff and "interest" at
20 11.22% (the amount of the ROE), subject to upward adjustments
based on tax and other considerations.

21 Viewed from the perspective of that analogy, the Municipal
22 Objectors essentially argue that the rate of interest is higher
23 than usual ("extraordinary," they argue). If so, that only means
24 that the present discounted value of the Regulatory Asset is
25 somewhat higher than its \$2.21 billion face amount. If the
26 Municipal Objectors believe that this makes the Regulatory Asset
too valuable or too costly for ratepayers, they had the
opportunity to argue to the Commission that the Settlement
Agreement is not a good bargain. The same is true for the
agreement for a minimum ROE of 11.22% and a minimum equity ratio
until PG&E returns to certain credit ratings.

27 In sum, the court will not second-guess whether the effect on
28 future rates is good or bad. All interested parties, including
ratepayers, had an opportunity to voice their opinions to the
Commission.

1 Santa Margarita court emphasized the binding nature of the
2 agreement on future versions of the governmental body that entered
3 into the contract:

4 A contract which 'appears to have been fair, just and
5 reasonable at the time of its execution, and prompted by
6 the necessities of the situation or in its nature
7 advantageous to the municipality at the time it was
8 entered into, is neither void nor voidable merely
9 because some of its executory features may extend beyond
10 the terms of office of the members' of the legislative
11 body which entered into the contract.

12 Id. at 232 (emphasis added)(citations omitted).

13 Like the Settlement Agreement here, the agreement in Santa
14 Margarita "represent[ed] the resolution of a protracted dispute
15 . . ." Id. at 231. Under the Settlement Agreement, the
16 Commission retains its power to set rates and regulate PG&E;
17 similarly, the governmental body in Santa Margarita retained the
18 right of review and final approval of the real estate development.
19 Like the contract in Santa Margarita, the Settlement Agreement is
20 "fair, just and reasonable at the time of its execution and
21 prompted by the necessities of the situation or in its nature
22 advantageous to the [Commission] at the time it was entered into."
23 Id. It is not void or voidable merely because its terms are
24 binding on future commissions. Id.

25 The Public Utilities Code does not contain any provision that
26 exempts the Commission from honoring contractual obligations. To
27 the contrary, where the Commission has elected to become a party
28 to a contract, the obligations created under that contract have
29 been enforced. Southern California Edison, 31 Cal.4th at 792.
30 Likewise, where other governmental agencies have contractually
31 agreed to certain rates, the contracts have been enforced. For

1 example, in Louisiana-Pacific Corp. v. Humboldt Bay Mun. Water
2 Dist., 137 Cal.App.3d 152, 156-57 (1982), the court enforced a
3 water district contract relating to water rates. The Humboldt Bay
4 Municipal Water District (the "District") had entered into a
5 series of contracts with Louisiana-Pacific Corporation ("L-P") in
6 the 1950s and 1960s setting sliding-scale prices L-P would pay for
7 water from the District until 1999. Id. at 154. In 1977, the
8 District determined that the existing contracts "constituted an
9 invalid limitation on the power of the [District's] Board to set
10 rates," and passed a resolution superseding the rate structure in
11 the pre-existing contracts. Id. at 155. The state appellate
12 court held that the District was estopped from setting rates that
13 conflicted with the prior contracts, explaining:

14 [W]here a municipality has both the power to contract as
15 to rates and also the power to prescribe rates from time
16 to time, if it exercises its power in contract, its
17 power to regulate the rates during the period of the
18 contract is thereby suspended, and the contract is
19 binding.

20 Id. at 161 (citations omitted).

21 Similarly, in Trans World Airlines v. City and County of San
22 Francisco, 228 F.2d 473 (9th Cir. 1956), the Ninth Circuit ruled
23 that the Public Utilities Commission of the City and County of San
24 Francisco ("SF CPUC") could not, through a resolution purporting
25 to establish rates, obviate a valid contract already agreed to by
26 the City of San Francisco. In 1942, the City entered into a 12-
27 year lease agreement with Trans World Airlines. Eight years
28 later, the SF CPUC passed a resolution fixing the charges "at a
figure higher than that set in the 1942 contract." Id. at 474.
The Ninth Circuit ruled that the City had "bound itself as to

1 rates and charges . . . by entering into a valid contract" and the
2 contract could not be "superseded by subsequent regulation,"
3 stating:

4 [I]t has been held in numerous cases, however, that a
5 state legislature unless prohibited by constitutional
6 provision may authorize a municipal corporation to
7 establish by an inviolable contract the rates to be
8 charged by a public utility for a reasonable term of
9 years, the effect of which is to suspend, during the
10 life of the contract, the governmental power of the
11 state or municipality to fix or regulate the rates.

12 Id. at 476-77 (citation omitted).

13 After considering section 701, Southern California Edison,
14 Santa Margarita, Louisiana-Pacific, and Trans World Airlines, this
15 court concludes that the Commission is authorized to enter into
16 the Settlement Agreement and to make the commitments necessary to
17 compromise its costly and hotly-contested disputes with PG&E in
18 furtherance of the goal of providing consumers of energy in
19 California with stable access to electrical and gas services.

20 This result is consistent with the interplay of section
21 1129(a)(11)'s feasibility requirement, section 1129(a)(6),
22 requiring commissions with jurisdiction to approve rates, and the
23 general notion that chapter 11 plans may include settlement and
24 compromises of claims. See 11 U.S.C. § 1129(b)(3)(A). The
25 Commission, Parent and PG&E are resolving, by contract, complex
26 disputes among them as a means of facilitating confirmation of
27 Debtor's reorganization plan.

28 2. The Settlement Agreement Does Not Improperly Delegate
Ratemaking Functions.

Contrary to the Municipal Objectors' assertions, the
Settlement Agreement does not improperly surrender the
Commission's section 728 ratemaking authority, nor does it

1 transform this court into a "regulatory Supreme Court" as they
2 fear. Like the Joint Plan and its related Reorganization
3 Agreement, the Settlement Agreement merely establishes minimum
4 components to be considered in setting PG&E's revenue
5 requirements. It does not fix or set rates. The Commission must
6 engage in traditional steps of determining other revenue
7 requirements, rate design, and ratemaking. Subject to certain
8 discrete limitations in the Settlement Agreement, rates can
9 fluctuate as they normally do.¹⁸ Therefore, section 728 -- which
10 permits the Commission to change utility rates if it determines
11 that those rates are "insufficient, unlawful, unjust,
12 unreasonable, discriminatory, or preferential. . ." -- is not
13 contravened by the Settlement Agreement.

14 In November 2002, this Court addressed the validity of the
15 Commission's proposed Reorganization Agreement, which, with
16 respect to ratemaking issues, contained similar terms to the
17 Settlement Agreement.¹⁹ Specifically, the court considered whether
18 the Commission, by proposing and entering into the Reorganization

19
20 ¹⁸ Paragraph 3c of the Settlement Agreement provides that
21 nothing therein ". . . shall be construed to create a rate freeze
or rate cap for PG&E's electric or gas business."

22 ¹⁹ The essential purposes of the Reorganization Agreement and
23 the Settlement Agreement are identical: to facilitate PG&E's re-
24 attainment of suitable credit ratings so that PG&E can issue
25 securities to pay its creditors and emerge from bankruptcy as
26 quickly as possible and continue to provide safe and reliable
27 electric and gas service at just and reasonable rates. Both
28 agreements obligate the Commission to permit the issuance of
securities to pay off claims of the creditors of PG&E and, for a
set period of time, to include certain costs as a component of
PG&E's revenue requirements. Both agreements also declare that
the Commission shall adopt such orders and decisions as necessary
to implement and carry out provisions of the agreements, and that
retail rates shall be sufficient to provide for payment of
securities and a regulatory asset.

1 Agreement, had abrogated its responsibilities to fix rates in the
2 future, impermissibly ceded to this Court jurisdiction vested in
3 California state courts, and improperly purported to bind future
4 commissions. In addition to holding that the Commission had the
5 power to enter into the Reorganization Agreement, this court held
6 that the Commission was "not setting rates under the
7 Reorganization Agreement, but [was] instead agreeing not to change
8 the rules of the game so as to reassure the financial markets and
9 to make the plan feasible." That is what it is doing here in the
10 Settlement Agreement.

11 Like the Settlement Agreement, the Reorganization Agreement
12 and the Joint Plan created a regulatory asset and allowed recovery
13 of costs in retail rates in connection with financing to be issued
14 under the Joint Plan. This court ruled that these provisions
15 merely created a "floor of costs which should be recoverable as
16 currently required by the law in any event." This court
17 specifically found that the Commission was not "setting rates"
18 under the Reorganization Agreement and that "[a]ny ratemaking must
19 occur as a separate matter."

20 While this court is not bound by its prior decision, the
21 legal principles and reasoning of that decision are equally
22 applicable here. The Settlement Agreement is not legal because
23 the Reorganization Agreement was. Both were and are legal. Even
24 though the Settlement Agreement contemplates a different size
25 regulatory asset and a set return on equity for a finite length of
26 time, it (like the Reorganization Agreement) sets necessary and
27 minimum components to be considered. The only differences are
28 financial; the monetary differences, however, do not change the

1 underlying legal analysis.

2 In any event, even if the Settlement Agreement did fix rates,
3 the Plan would still be confirmable. Section 1129(a)(6)
4 specifically allows confirmation of a plan containing a rate
5 change as long as the rate change is approved by the commission
6 having jurisdiction over those rates.²⁰ Here, confirmation of the
7 Plan has been conditioned upon the Commission's approval of the
8 Settlement Agreement. Because it gave that approval in the
9 December 18 Decision, any doubt about which body is engaging in
10 ratemaking has been removed and section 1129(a)(6) will be
11 satisfied. Thus, this court may lawfully confirm the Plan.

12 The Municipal Objectors cite Bock v. Lompoc City Council, 109
13 Cal.App.3d 52 (1980), in support of their contention that the
14 Settlement Agreement unlawfully removes from future commissions
15 the authority to set rates. Bock, however, is distinguishable.
16 In that case, an individual ("Bock") submitted to the Lompoc City
17 Council ("Council") an initiative petition which he requested the
18 Council to place on the ballot. Id. at 54. That initiative
19 contained a proposed ordinance which would have required the
20 Council (which set the retail rates for electricity sold by the
21 City of Lompoc) to charge its residential customers a rate
22 identical to the lifeline rate charged by PG&E to its customers.

23
24 ²⁰ Section 1129(a)(6) provides:

25 Any governmental regulatory commission with
26 jurisdiction, after confirmation of the plan, over the rates
27 of the debtor has approved any rate change provided for in
the plan, or such rate change is expressly conditioned on
such approval.

28 11 U.S.C. § 1129(a)(6).

1 Id. at 54-56. The Council refused, and Bock sought a writ of
2 mandamus. The appellate court denied the relief sought by Bock.

3 In its ruling, the court noted that two sets of factors
4 determine PG&E's lifeline rate and "neither set of factors used in
5 that determination has any rational relevance to the electrical
6 utility rates appropriate for the City [of Lompoc]." Id. at 56.
7 "As a result of the factual dissimilarities between the two
8 utilities, PG&E's lifeline rate bears no reasonable relationship
9 to the rate Lompoc might need to charge its residential
10 customers." Id. at 56. Yet, Bock wanted the City Council to use
11 whatever lifeline rate had been established by the Commission for
12 PG&E's customers; the Council would not have had any flexibility
13 to set its own rates. Thus, the "result would be a utility rate
14 that is irrational and arbitrary, and this would constitute an
15 unlawful delegation of authority." Id.

16 Unlike the rate-setting governmental body in Bock, the
17 Commission here and future commissions still have the flexibility
18 to set and charge rates. No rate is being imposed by an outside
19 agency or by the Settlement Agreement; future commissions are not
20 compelled to set rates identical to those imposed by another
21 entity. Moreover, the components which are to be incorporated
22 into future revenue requirements here were negotiated (with
23 judicial supervision) and rationally relate to the goals of
24 allowing PG&E to emerge from bankruptcy as a regulated utility.
25 They are not "irrational and arbitrary." Id.

26 Similarly, the Municipal Objectors cite City and County of
27 San Francisco v. Patterson, 202 Cal.App.3d 95, 105 (1988), for the
28 proposition that "no legislative board, by normal legislative

1 enactment, may divest itself or future boards of the power to
2 enact legislation within its competence." Id. (internal quotation
3 marks and citations omitted). This court has no quarrel with this
4 unremarkable legal proposition set forth in Patterson and other
5 cases upholding legislative integrity. Nonetheless, that
6 proposition and Patterson are inapplicable here. In Patterson, a
7 proposed initiative ordinance limiting the power of all future
8 boards of education to sell or release real property was struck
9 down on the ground that because the current board could not
10 lawfully bind all future boards to a particular policy, the
11 electorate was similarly barred from doing so absent amendment to
12 the city charter. There is a significant difference between
13 enacting legislation that would bind all future boards to a
14 particular policy and entering a compromise agreement that covers
15 a fixed period of time (nine years) and provides value to a
16 legislative board and its constituents.²¹ Although future
17 commissions' powers will have to be exercised subject to the
18 Settlement Agreement, the same was true in Southern California
19 Edison, and some effect on future ratemaking is inherent in any
20 settlement. In any event, as discussed, supra, the Settlement
21 Agreement's temporary and limited effects on components of PG&E's
22 revenue requirements do not amount to ratemaking. The bottom line
23 is that future commissions' powers have not been illegally

24
25 ²¹ Here, the Commission is receiving significant
26 consideration from Parent and PG&E. They are dismissing high-
27 stakes litigation with the potential for recovery in the form of
28 increased rates that could amount to billions of dollars,
foregoing dividends for a period of time, and abandoning efforts
to disaggregate and eliminate Commission oversight of much of
PG&E's operations.

1 usurped. Thus, Patterson and similar cases are distinguishable.

2 3. The Settlement Agreement Is Binding on Future
3 Commissions.

4 Objectors contend that the Plan is not feasible because,
5 under section 1708, the Commission may renege on its promises made
6 in the Settlement Agreement. Section 1708 is a permissive grant
7 of authority that allows the Commission "at any time, upon notice
8 to the parties, and with opportunity to be heard as provided in
9 the case of complaints, rescind, alter or amend any order or
10 decision made by it." Pub. Util. Code § 1708. Objectors also
11 contend that the Settlement Agreement is not enforceable under In
12 re Pacific Gas & Electric Co., 99 P.U.R. 4th 141, 1988 WL 391219
13 (C.P.U.C. 1988) ("Diablo Canyon"). In Diablo Canyon, the
14 Commission approved a settlement agreement to which it was not a
15 party. In dicta, the Commission warned that future commissions
16 could revoke the approval under section 1708. The Objectors'
17 argument misapprehends the distinction in California law between a
18 decision by the Commission and a contract to which the Commission
19 is a party.

20 Section 1708 and Diablo Canyon do not preclude future
21 enforcement of contracts. Diablo Canyon did not involve a
22 contractual obligation by the Commission. Rather, it dealt with a
23 Commission decision to approve a settlement among other parties,
24 namely the Commission's Division of Ratepayer Advocates, the AG
25 and PG&E. Here, by contrast, the Commission has approved the
26 Settlement Agreement and has become a party to that agreement.
27 Thus, although Commission decisions are subject to modification
28 under section 1708, the Commission's contractual obligations are

1 not. And, as discussed earlier, the Public Utilities Code does
2 not contain any provision that exempts the Commission from
3 honoring contractual obligations.

4 4. Specific Provisions of the Settlement Agreement.

5 The Municipal Objectors cite numerous provisions of the
6 Settlement Agreement that they believe are either impermissible
7 attempts to bind future Commissions or else too vague to be
8 enforceable. Alternatively, they argue, even if the Settlement
9 Agreement is enforceable it should not be approved because PG&E
10 intends to take advantage of this vagueness to argue later that
11 the Commission has bound itself under federal law to provisions
12 that would violate state law.

13 The Municipal Objectors focus on three provisions. First,
14 Settlement Agreement Paragraph 2.g. states:

15 g. The Commission recognizes that the establishment,
16 maintenance and improvement of Investment Grade company
17 credit ratings is vital for PG&E to be able to continue to
18 provide safe and reliable service to its customers. The
19 Commission further recognizes that the establishment,
20 maintenance and improvement of PG&E's Investment Grade
21 company credit ratings directly benefits PG&E's ratepayers by
22 reducing PG&E's immediate and future borrowing costs, which,
23 in turn, will allow PG&E to finance its operations and make
24 capital expenditures on its distribution, transmission, and
25 generation assets at lower cost to its ratepayer. In
26 furtherance of these objectives, the Commission agrees to act
27 to facilitate and maintain Investment Grade company ratings
28 for PG&E. [Emphasis added.]

23 In the future, the Municipal Objectors claim, PG&E may rely
24 on this provision to argue that "this Court must order the
25 Commission to act more favorably than it otherwise would in order
26 to maintain and improve PG&E's Investment Grade credit ratings."
27 The Municipal Objectors ask this court to anticipate this possible
28 interpretation and rule that this is impermissible because it

1 would require the Commission to pay a higher amount than the
2 maximum otherwise allowable under applicable California law.

3 Second, the Municipal Objectors cite Settlement Agreement
4 Paragraph 2.j., which states:

5 j. The Commission agrees that, in the absence of
6 compelling evidence to the contrary, PG&E's expected
7 regulatory outcomes and financial performance should be
8 similar to those of other investor-owned energy utilities in
9 California under similar circumstances. In furtherance of
10 the foregoing, the Commission shall not discriminate against
11 PG&E by reason of the Chapter 11 Case, the Rate Recovery
12 Litigation, this Agreement, the Regulatory Asset or any other
13 matters addressed or resolved herein. [Emphasis added.]²²

14 The Municipal Objectors urge this court to conclude that the
15 phrase, "in the absence of compelling evidence to the contrary"
16 does not change the standard of proof under California law. They
17 also want this court to determine that because California's energy
18 utilities are inherently "dissimilar" the requirement for similar
19 treatment essentially "has no meaning or legal significance."
20 They urge this court to rule that the quoted paragraph "does not
21 change the applicable standard(s) of proof or law applicable to
22 such matters stated therein" and that it would only be enforceable
23 to the extent the Commission "willfully" denies PG&E the benefit
24 of applicable law "in bad faith for retribution."

25 Third, the Municipal Objectors object that Settlement
26 Agreement Paragraph 36 refers to rights that "vest" without
27 defining those rights:

28 36. Termination. This Agreement shall terminate at the
end of nine (9) years from the Effective Date, provided that
all rights of the Parties under this Agreement that vest on
or prior to such termination, including any rights arising

29 ²² The Municipal Objectors call this a "most-favored nation"
30 clause. It is not. It is a "no-discrimination" clause, not too
31 dissimilar from what is found in section 525.

1 from any default under this Agreement, shall survive such
2 termination for the purpose of enforcing such vested rights.
[Emphasis in original.]

3 To illustrate the alleged vagueness of the Settlement
4 Agreement, Objectors' counsel asked witnesses from PG&E and the
5 Commission's staff about the meaning of various provisions. The
6 witnesses invariably testified that they would have to rely on
7 counsel to interpret the Settlement Agreement's legal meaning, or
8 else that the agreement speaks for itself, or else they qualified
9 their views as being strictly a matter of personal opinion.

10 Several Objectors argued that the Settlement Agreement's meaning
11 can never be discerned because it has no "legislative history" --
12 it was negotiated in the course of confidential settlement
13 discussions and Judge Newsome and this court have not permitted
14 disclosure of those discussions.

15 These arguments as to specific provisions of the Settlement
16 Agreement are not persuasive. The court rejects them for the
17 following reasons.

18 a. No Change in California Law.

19 Included within the foregoing objections are arguments as to
20 the merits of the specific settlement terms, but as this court has
21 already stated, that is primarily an issue for the Commission.
22 Also included are arguments that the Settlement Agreement changes,
23 or may in future be read to change, California energy utility law.

24 The court has already ruled that ratepayers as such (as
25 opposed to creditors who happen to be ratepayers) lack standing in
26 these proceedings. This is not the forum for ratemaking or for
27 making decisions about California energy policy; that is for the
28 state legislature, the Commission or other state agencies. In

1 this context, it would be both impractical and inappropriate for
2 this court to determine whether, for example, the Settlement
3 Agreement's proposed language as to the "absence of compelling
4 evidence to the contrary" (Settlement Agreement Paragraph 2.j.)
5 would change the standards of proof under California law, as the
6 Municipal Objectors argue. Fortunately, this court does not need
7 to decide these types of issues.

8 Despite its broad discretion in ratemaking and matters of
9 energy policy, the Commission cannot change state law. If the
10 Settlement Agreement is intended to make any change in state law
11 then that change must be disapproved. This court is prohibited
12 from approving any attempt by the Commission to consent either to
13 change state law or to be enjoined from enforcing state law. See
14 Southern California Edison v. Lynch, 307 F.3d at 809 and 812; Cal.
15 Const. Art. III, Sec. 3.5; Southern California Edison v. Peevey,
16 31 Cal.4th at 787.

17 This is neither a fatal flaw in the Settlement Agreement nor
18 a condition upon the court's approval of it or the Plan. PG&E's
19 counsel have reassured the court that they know of no specific
20 state law being preempted. In particular, they have represented
21 that there is no switching of the traditional burdens of proof.
22 Moreover, the Ninth Circuit has ruled that any express preemption
23 of California law applies only to specific types of laws, and that
24 any implied preemption must be explicitly proven. Pacific Gas and
25 Elec. Co. v. California, supra, 350 F.3d 932, 948-49. No party
26 has argued in these proceedings that either of these conditions
27 has been, nor needs to be met. The Settlement Agreement's
28 provision regarding "vested rights" (Paragraph 36) is apparently

1 intended only to assure that the Settlement Agreement will not be
2 eviscerated by a future commission's second thoughts or by future
3 changes in the law. It will not. Without pre-judging issues that
4 may arise in future, the court can confidently state that PG&E's
5 rights under the Settlement Agreement will vest pursuant to
6 applicable state and federal law, and this court's determinations
7 will become binding under principles of res judicata, law of the
8 case, etc. See, e.g., Keith v. Volpe, 118 F.3d 1386, 1390 (9th
9 Cir. 1997) (federal court can enjoin state proceedings that
10 interfere, derogate or conflict with federal judgments, orders, or
11 settlements). Thereafter, any attempt to alter the terms of the
12 Settlement Agreement (other than by mutual consent) or obtain a
13 determination contrary to this court's present determinations will
14 be barred by those same principles.

15 In other words, the Settlement Agreement will not change
16 state law, but it will assure that PG&E gets the benefit of its
17 bargain. Having acted in reliance on the Settlement Agreement (by
18 dismissing its pending litigation, agreeing to be bound by the
19 Plan, foregoing the Original Plan, deferring dividends, etc.),
20 PG&E and Parent will be able to enforce the Settlement Agreement.
21 This is no more and no less than what the Plan Proponents have
22 asked for. This is no more and no less than insisting the
23 counterparty to a contract agree to be bound by it. Finally,
24 agreeing to enforcement in this court is much the same as a
25 traditional forum-selection clause.

26 b. Other Provisions that Purport to Bind or
27 Delegate Future Commissions' Discretion.

28 While other provisions of the Settlement Agreement might

1 affect in some fashion future commissions' discretion, the
2 Settlement Agreement is closer to what is permitted under Southern
3 California Edison and Santa Margarita than to what is prohibited
4 by Bock and Patterson.

5 At the most general level, the Settlement Agreement appears
6 to be predicated on the Commission continuing to apply cost-of-
7 service ratemaking. This might limit future commissions'
8 discretion to change to a different system. During the
9 confirmation hearings, the court asked PG&E's counsel what would
10 happen if the Commission were to choose (or be required) to change
11 to a different system, like locational marginal pricing. The
12 response was that the Commission would not be barred from adopting
13 a new system, but that PG&E would still be entitled to benefits at
14 least as great as what it would have received under the Settlement
15 Agreement.

16 This is consistent with this court's view of the Settlement
17 Agreement as a binding settlement of PG&E's claims. The
18 Settlement Agreement essentially determines, among other things,
19 that PG&E is entitled to recovery on account of various claims.
20 Future commissions will be bound by that determination, both as a
21 matter of contract and because the settlement will be binding
22 under principles such as res judicata. Future commissions should
23 not be able to eliminate this obligation by changing to a new
24 system of ratemaking. Future commissions will also be bound to
25 comply with non-monetary obligations.

26 The Commission and PG&E might have different interpretations
27 of the Settlement Agreement, and one or more of the parties might
28 call upon this court to resolve those differences. If so, this

1 court will determine the issue. It is impossible to predict
2 exactly what disputes might arise regarding the Settlement
3 Agreement. Nevertheless, based on the foregoing review this court
4 is satisfied that the Settlement Agreement can be read not to bind
5 future commissions beyond what is permitted by California law.
6 Similarly, the Settlement Agreement can be read not to permit any
7 greater delegation than is permitted by California law.

8 c. The Settlement Agreement Is Not Too Vague.

9 The legal issue is whether the Settlement Agreement is so
10 vague as not to be an agreement at all, or at least so vague as to
11 doom the Plan to failure, viz. not legally feasible, as contrasted
12 with not financially feasible. See generally 1 B.E. Witkin,
13 Summary of Cal. Law (9th) Contracts, §§ 119 et seq. (objective
14 theory of mutual consent), 145 et seq. (certainty of offer), and
15 365 et seq. (mistake). This court believes that the Settlement
16 Agreement is not so vague that consent is vitiated or mutual
17 mistake (or another legal theory) exists that would invalidate it.

18 At the confirmation trial, while the court was considering
19 the PSA and obviously prior to the December 18 Decision, some
20 Objectors argued that there was no meeting of the minds by the
21 parties to that agreement. The court rejected that argument in
22 the original memorandum decision of December 12, 2003. Since then
23 the Commission has spelled out in great detail its understanding
24 concerning many provisions of the Settlement Agreement, and PG&E
25 and Parent have not only acquiesced in those understandings, they
26 have specifically incorporated the December 18 Decision into, and
27
28

1 made it a part of the Settlement Agreement.²³ While there was
2 little doubt on December 12, 2003, about the presence of a valid
3 and enforceable agreement, there is none now.

4 The fact that there may be uncertainty about some terms, or
5 that enforcement might be difficult, or that each and every
6 hypothetical forecasted situation does not lend itself to a simple
7 solution, is no reason to decline to approve the Settlement
8 Agreement based on some perceived vagueness. The essential terms,
9 sufficient to bind the parties, are unmistakably present.

10 Countless agreements might fail judicial approval before-the-fact
11 if the outcome of each and every future scenario had to be
12 predicted with certainty. The "proof will be in the pudding"
13 after-the-fact and the court will not withhold approval of the
14 agreement just because enforcement in the future might present a
15 difficult challenge to it and to the parties.

16 **B. The Releases Are Permissible.**

17 1. Debtor May Release Any And All Claims It or The
18 Estate May Have Against Parent.

19 Section 1123(b)(3)(a) permits a plan to settle or adjust any
20 claim belonging to the debtor or to the estate. The Objectors
21 object to those provisions of the Plan which release claims that
22 are held by, assertable on behalf of, or derivative of the rights
23 of Debtor and the estate and assert that those release provisions
24 should be disapproved by this court under the standards
25 articulated by the Ninth Circuit for compromises under Rule 9019.

26 ²³ Paragraph 27 of the Settlement Agreement states that the
27 Settlement Agreement and its appendices, including the December 18
28 Decision, the Plan and the Confirmation Order "contain the entire
understanding of the Parties concerning the subject matter of [the
Settlement Agreement]...."

1 See Fed. R. Bankr. P. 9019(a); Martin v. Kane (In re A&C
2 Properties), 784 F.2d 1377, 1381 (9th Cir. 1986).

3 Given that section 1123(b)(3)(A) permits a plan of
4 reorganization to include settlements, and given the overwhelming
5 votes in favor of the Plan, such review might be unnecessary.
6 Nevertheless, since there is some uncertainty (see, e.g., In re
7 Public Service Co., 114 B.R. 820, 826-27 (Bankr. D.N.H. 1990)
8 (applying Rule 9019 factors to settlement included in plan of
9 reorganization)), the standards under Rule 9019 will be applied.
10 The court will discuss the releases as if Rule 9019 governs, but
11 it would reach the same result under either of these standards.

12 This court's role in approving any settlement under Rule 9019
13 is limited. Rather than an exhaustive investigation or a mini-
14 trial on the merits, this court need only find that the settlement
15 was negotiated in good faith and is reasonable, fair and
16 equitable. A&C Properties, 784 F.2d at 1381. It has been held
17 that the court's proper role is "to canvas the issues and see
18 whether the settlement falls below the lowest point in the range
19 of reasonableness." In re Drexel Burnham Lambert Group, Inc., 134
20 B.R. 493, 496-97 (Bankr. S.D.N.Y. 1991) (citations and internal
21 quotation marks omitted); 10 L. King, Collier on Bankruptcy
22 ¶ 9019.02 at p. 9019-5 (15th ed. rev. 2003). Applying these
23 general principles, this court must consider:

- 24 (a) The probability of success in the litigation;
25 (b) the difficulties, if any, to be encountered in the
26 matter of collection;
27 (c) the complexity of the litigation involved, and the
28 expense, inconvenience and delay necessarily
attending it;

1 (d) the paramount interest of the creditors and a
2 proper deference to their reasonable views in the
premises.

3 A&C Properties, 784 F.2d at 1381 (paragraph lettering added;
4 citations omitted).

5 It is not necessary to satisfy each of these factors provided
6 that the factors as a whole favor approving the settlement. See,
7 e.g., In re WCI Cable, Inc., 282 B.R. 457, 473-74 (Bankr. D. Or.
8 2002) (although debtor "likely would prevail on one or more causes
9 of action" and court-appointed examiner suggested that
10 "probability of success on the merits, considered in isolation,
11 militated against the proposed settlement," nevertheless court
12 agreed with examiner that settlement should be approved because of
13 other factors).

14 The A&C Properties factors are satisfied in this case. With
15 respect to the first factor, PG&E's witnesses testified that in
16 their view the claims against Parent were worthless. Although the
17 Objectors cast some doubt on the objectivity of this evidence, the
18 testimony is nevertheless entitled to at least some weight, and
19 the Objectors presented no contrary evidence.

20 As to the second factor, although nobody has suggested that
21 Parent lacks the resources to pay any judgment, there might be
22 some delay and difficulty in collection because Parent has
23 demonstrated its willingness to use those resources in aggressive
24 and often protracted litigation. In addition, as noted, supra, it
25 is not necessary to satisfy each of the A&C Properties factors.
26 See WCI Cable, 282 B.R. at 473 ("these parties play for keeps and
27 do not give quarter"; approving settlement despite fact that
28 probability of success, considered in isolation, militated against

1 settlement).

2 With respect to the third factor, the issues being settled
3 are very complex and that resolving them will avoid considerable
4 expense, inconvenience, uncertainty and delay. The court is quite
5 familiar with the battles on the Original Plan, the disclosure
6 statement hearings and subsequent appeals, the contested
7 confirmation hearings, hearings concerning removal of causes of
8 action, and the failed attempt by PG&E to enjoin the Commission
9 (Pacific Gas and Elec. Co. v. Cal. Public Utilities Comm'n (In re
10 Pacific Gas and Elec. Co.)), 263 B.R. 306 (Bankr. N.D. Cal. 2001).

11 Finally, as to the fourth factor, the overwhelming majority
12 of creditors voted in favor of the Plan, including its provisions
13 for releases, and the OCC as their official representative is a
14 Plan Proponent. Since the Plan will pay creditors in full, with
15 interest, the logical inference is that those few creditors who
16 objected to releases of the Parent did so as ratepayers, not as
17 creditors. The releases are a requirement for confirmation of the
18 Plan, and there is no question that after two and a half years
19 creditors should be paid. Therefore, the "paramount interest of
20 creditors and a proper deference to their reasonable views in the
21 premises" favors approval of the releases.²⁴

22 Because the releases contained in the Settlement Agreement
23 satisfy the A&C Properties inquiry, the court has approved the
24 releases as part of the Confirmation Order.

25

26

27

28 ²⁴ It should go without saying that PG&E's shareholders,
primarily Parent, desire the same result.

1 2. There Are No Impermissible Third-Party Releases in
2 the Plan or Settlement Agreement.

3 Objectors, particularly the AG, contend that the Plan
4 improperly releases nondebtors Parent and its officers and
5 directors from "any claim or cause of action brought by third
6 parties but does not belong to the debtor or the estate."²⁵ As it
7 did in its motion for summary judgment heard by this court on
8 October 16, 2003, the AG contends that the release provisions in
9 the Plan are purposefully ambiguous and overly broad and
10 improperly discharge claims against third parties (i.e., Parent
11 and its officers and directors).²⁶ The court disagrees and

12 ²⁵ In particular, the AG is concerned that the releases will
13 extinguish claims brought against the Parent by it and others
14 (including CCSF) pursuant to California Business & Professions
15 Code section 17200 (the "§ 17200 Actions"). The § 17200 Actions
16 have been the subject of several motions in the this court and of
17 several appeals to the District Court. Specifically, this court
18 issued a ruling on three motions to remand the § 17200 Actions to
19 state court. See In re Pacific Gas and Electric Co., 281 B.R. 1
20 (Bankr. N.D. Cal. 2002). The District Court affirmed this
21 decision in part and reversed it in part (in an unpublished
22 decision in Civil Actions No. C-02-3668-VRW, C-02-4071-VRW, and C-
23 02-4330-VRW). An appeal is currently pending before the Ninth
24 Circuit.

25 The District Court held that a portion of the claims in the
26 § 17200 Actions belong to the Debtor's estate. That ruling
27 (unless reversed on appeal) is law of the case. These claims
28 belonging to the estate are released under the Plan. Claims that
29 may be asserted directly by third parties against nondebtors are
30 not released by the Plan. Consequently, Debtor has conceded that
31 those portions of the § 17200 Actions seeking injunctive relief
32 and penalties (which are directly assertable by the AG) are not
33 released. Paragraph 22 of the Confirmation Order reflects this
34 disposition of these claims. For this reason the court denies as
35 moot AG's Motion For Summary Judgment Regarding Illegal Third
36 Party Release Provisions in the PG&E/OCC Plan.

37 ²⁶ The AG contends that, under In re Lowenschuss, 67 F.3d
38 1394, 1401-02 (9th Cir. 1995), the Plan is unconfirmable because
39 it releases a nondebtor. 11 U.S.C. § 524(e). This court is bound
40 by, and does not question, the legal principle set forth in
41 Lowenschuss, in In re American Hardwoods, Inc., 885 F.2d 621, 626

1 overrules this objection. As the court ruled at the motion for
2 summary judgment, the release provisions are not overly broad.
3 Language satisfactory to the AG has been included in the
4 Confirmation Order.

5

6 **VII. CONCLUSION**

7 For the foregoing reasons and as reiterated in the
8 "Conclusions of Law Required By the Plan of Reorganization Under
9 Chapter 11 of the Bankruptcy Code for Pacific Gas and Electric
10 Company", the Settlement Agreement has been approved and the Plan
11 confirmed in the Confirmation Order.

12

13 Dated: January 5, 2004

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S/ _____
Dennis Montali
United States Bankruptcy Judge

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22 (9th Cir. 1989), and in Underhill v. Royal, 769 F.2d 1426, 1432
23 (9th Cir. 1985) that liabilities of nondebtors cannot be
24 discharged through a plan. This legal principle, however, is
25 inapplicable here because (unlike in Lowenschuss, American
26 Hardwoods, and Underhill) the Plan does not discharge or release
27 nondebtors from claims that belong to others (except the
28 Commission, which has consented to the release). Those cases did
not involve the release by a debtor of only claims which were held
by, assertable on behalf of, or derivative of the debtor, and did
not involve a confirmation order containing language acknowledging
that the plan did not release claims which may be asserted
directly by third parties against nondebtors. As noted
previously, it is permissible for a plan to provide for the
settlement or adjustment of any claim "belonging to the debtor or
to the estate." 11 U.S.C. § 1123(b)(3)(A).