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UNITED STATES BANKRUPTCY COURT

NORTHERN DISTRICT OF CALIFORNIA

In re	)	No.	01-30923 DM
PACIFIC GAS AND ELECTRIC COMPANY,	)	Chapter	11
Debtor.	)	Date:	December 19, 2001
	)	Time:	9:30 a.m.
	)	Ctrm:	Hon. Dennis Montali 235 Pine Street, 22nd Floor San Francisco, California

UNITED STATES TRUSTEE'S
OBJECTION TO DISCLOSURE STATEMENT

Linda Ekstrom Stanley, United States Trustee, submits this objection to the Disclosure Statement for Plan of Reorganization under Chapter 11 of the Bankruptcy Code for Pacific Gas and Electric Company (the "Disclosure Statement"), describing the Plan of Reorganization (the "Plan") submitted by debtor Pacific Gas and Electric Company ("debtor") and its parent, PG&E Corp. The Disclosure Statement should not be approved because it is incomplete and therefore does not contain adequate information.

The Plan would permit debtor to transfer its most valuable assets – electrical generation, gas transmission and electrical transmission – to companies controlled by its parent PG&E Corp. The transferee companies have no intention of paying debtor fair market

value for the assets. Instead, they will pay only a portion of the asset value in cash and notes to debtor's creditors. Debtor, stripped of its valuable assets, will shoulder the responsibility of paying than $9 billion of the $13.2 billion in projected claims. The disclosure statement does not describe why this proposal is appropriate. To understand whether the proposal is fair and in the best interests of creditors, the Disclosure Statement should provide the fair market value of assets being transferred. Armed with this information, creditors will be able to compare the value of the assets to the amount debtor's former affiliates have agreed to pay creditors.

The Disclosure Statement is inadequate because it does not include copies of important agreements, among them the Separation Agreement by which debtor would transfer its assets to limited liability companies and the Power Purchase Agreement under which debtor would purchase electrical power supplies for at least 12 years at unspecified rates from the very companies to which it intends to transfer its assets. Debtor does not indicate whether it intends to object to any claims and the basis for any objections.

For the reasons set forth below, the Disclosure Statement is inadequate should not be approved.

ARGUMENT

I. THE UNITED STATES TRUSTEE HAS STANDING TO OBJECT TO THE DISCLOSURE STATEMENT

The United States Trustee has standing to be heard on an objection to a debtor's disclosure statement. 11 U.S.C. § 586(a)(3)(B) specifically authorizes the United States Trustee to:

> [M]onitor plans and disclosure statements filed in cases under chapter 11 of title 11 and [file] with the court, in connections with hearings under sections 1125 and 1128 of such title, comments with respect to such Plans and disclosure statements.

II. THE DISCLOSURE STATEMENT MUST CONTAIN "ADEQUATE INFORMATION" UNDER 11 U.S.C. § 1125(a)

The Bankruptcy Code requires that any disclosure statement contain "adequate information." Adequate information is defined by the Bankruptcy Code as:

> [I]nformation of a kind, and in sufficient detail, as far as is

> reasonably practicable in light of the nature and history of the debtor and the condition of the debtor's books and records, that would enable a hypothetical reasonable investor typical of holders of claims or interests of the relevant class to make an informed judgment about the plan . . .

11 U.S.C. § 1125(a)(1). Courts have interpreted the statute to require a broad range of disclosure, from the reasons for the filing to the proposals for restructuring. *See In re Scioto Valley Mortgage Co.*, 89 B.R. 168, 170-71 (Bankr. S.D. Ohio 1988); *Hall v. Vance*, 887 F.2d 1041, 1043 (8th Cir. 1989). The Disclosure Statement does not provide the information required by 11 U.S.C. § 1125 for the following reasons:

A. Debtor Intends to Spin Off Valuable Assets But Fails to Say What Those Assets are Worth

The Bankruptcy Courts impose a nearly universal requirement that chapter 11 debtors disclose the nature and value of estate assets. *In re Scioto Valley Mortgage Co.*, 89 B.R. at 170. Debtor's Disclosure Statement does comply with this requirement. Debtor's plan calls for debtor to divest itself of all its generation assets (nuclear and hydroelectric) in exchange for notes from the limited liability companies (Gen, GTrans and ETrans, collectively, the "LLCs") which will be owned by debtor's parent, PG&E Corp. The Disclosure Statement indicates the LLCs will pay debtor $1.360 billion in cash and $2.7 billion in notes for their assets for a total of $4.06 billion, or 31% of the total debt of $13.2 billion. The remainder of the $13.2 billion in creditor payments, or $9.140 billion (69% of total debt), will come directly from debtor. The vast majority of payments to creditors will depend on how much cash is held by debtor at confirmation, how much it borrows and its future operating results.

The disclosure is inadequate because it fails to show the high value of the assets being spun off. At the United States Trustee's request debtor provided the most recent third party appraisal of the utility's hydroelectric facilities. The appraisal debtor supplied took the form of testimony on December 5, 2000, before the CPUC by Joseph Savage, of Lehman Brothers. *Declaration of Patricia A. Martin in Support of U.S. Trustee's Objection to Disclosure Statement,* Exhibit A. Lehman Brothers attributed a market value range of $3.9 billion to $4.2 billion for debtor's hydroelectric assets. *Id.* Lehman Brothers valuation excluded the approximately 140,000 acres of land associated with the hydroelectric assets.

The defect in the Disclosure Statement is its failure to match the value of assets being spun off against financial burden being incurred by the companies acquiring the assets. The generation assets are the clearest example of the problem. Why are the generation assets only assessed $4.1 billion for payment of claims when the hydroelectric portion of those assets alone was valued at between $3.9 billion and $4.2 billion? Surely combined with the nuclear assets, debtor's generation assets are worth far more than the $4.1 billion total claims they will pay under the plan. It is difficult to understand why debtor, stripped of its hydroelectric generation assets, stripped of its nuclear generation assets, stripped of its gas and electrical transmission assets, has been assigned the lion's share of the cost of the break up, $9.14 billion dollars. Disclosure of the basis for this conclusion is particularly important here because debtor and its parent's boards of directors are identical with the exception of one member.

It is impossible to determine from the Disclosure Statement whether the proposed breakup methodology is appropriate and fair to creditors or not.[1/] If PG&E Corp.'s new subsidiaries the LLCs borrowed more and paid sooner, debtor's creditors might be paid more quickly on their claims. Debtor should explain in detail how it arrived at the capital assignments in the proposed break up so parties in interest can determine whether the break up is the best means of being paid as quickly as possible.

B. The Disclosure Statement Does Not Say Whether Debtor Intends to Object to Any Claims or Not

The Disclosure Statement does not contain any discussion about whether debtor intends to object to any claims. It is better practice for a chapter 11 debtor to say in its disclosure statement whether it intends to object to claims or not. *See Kelley v. South Bay Bank (In re Kelley)*, 199 B.R. 699, 703 (Bankr. 9th Cir. 1996) ("Bankruptcy Code policy favors disclosure of all potential causes of action" and a post-confirmation lawsuit barred by *res judicata* when debtor fails to disclose an offsetting claim). There is no reason to deviate from

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[1/] It is impossible for parties in interest to refer to debtor's schedules on this point; debtor's schedules were prepared at book value. Debtor's amended schedules list assets at book value of $31.7 billion and liabilities of $14.1 billion, for a net excess of assets over liabilities of $17.6 billion.

that policy here.

Reading through the lines, it appears debtor may intend to raise objections to certain claims. There is a hazy reference on page 19 of the Disclosure Statement to claims of "Generators" and in footnote 4 to "*Allowable* ISO, PX and Generator Claims." The term "Allowable ISO, PX and Generator Claims" is not defined, though, so it is difficult to determine whether debtor intends to interpose objections to any of those claims. Debtor should revise the Disclosure Statement to indicate whether it will object to claims, which claims it will object to, and the fundamental basis for any objections.

C. The "Plan Supplement" Must Be Filed Immediately

Throughout the Disclosure Statement, debtor refers to important details that will be provided in a "Plan Supplement" debtor intends to file 10 days prior to voting. The document will not be provided to plan voters, though, it will only be "filed" with the court and available for inspection.[2] The timing of the filing is unacceptable because creditors are being asked to vote on a reorganization without the benefit of material information.

The importance of the terms apparently set forth in the Plan Supplement but omitted from the Disclosure Statement would be difficult to overstate. The Plan Supplement is supposed to include a copy of the "Separation Agreement" between the debtor, PG&E Corp. and the LLCs. The Separation Agreement will describe the precise assets being disposed of, their location and the intended repository for those assets. It seems (but the Disclosure Statement does not expressly provide) that it will discuss the allocation of assets. (*See* Disclosure Statement, 92:18 ff).

The Plan Supplement is supposed to include a copy of the "Power Purchase Agreement" between debtor and newly created LLC Gen (Disclosure Statement 85:6-8). The Power Purchase Agreement is the contract by which debtor will purchase the power generated by its former generation assets. The contract's duration is 12 years. Without

[2] "The Plan Supplement shall be file with the Clerk of the Bankruptcy Court at least ten (10) days prior to the last day upon which holders of Claims and Equity Interests may vote to accept or reject the Plan. Upon its filing with the Bankruptcy Court, the Plan Supplement may be inspected in the office of the Clerk of the Bankruptcy Court during normal court hours." Plan of Reorganization sec. 11.18 at p. 77 (emphasis added).

access to the Power Purchase Agreement, it is impossible to determine how much debtor will pay for power and what other conditions will be imposed on debtor.

The Plan Supplement is supposed to include information on the proposed directors and officers of the newly formed LLCs and debtor and their compensation. This information should be provided prior to voting because it is a requirement of plan confirmation. 11 U.S.C. § 1129(a)(5)(A). The companies intend to use billions in loans to repay creditors over a period as long as 30 years. Creditors are entitled to evaluate the management team which will carry out the terms of the Plan.

D. Debtor Failed to Describe In Any Meaningful Fashion Alternatives to Its Plan of Reorganization

Beginning at 174:9, the Disclosure Statement includes a cursory discussion of the effect of conversion, chapter 11 liquidation and alternative plans. None of these comes close to describing in any detail the true alternatives to the proposed reorganization of the estate. Instead, creditors are asked to approve the proposed Plan on a take-it-or-leave-it basis. The United States Trustee believes it would be appropriate to have a schedule appended to the Disclosure Statement to describe the potential recovery and timing of a liquidation under chapter 7 and a liquidation under chapter 11. If the estate is solvent, as debtor steadfastly maintains, this information is important to creditors who are asked to wait up to 30 years to recover completely on their claims.

E. The Pro-Forma Financial Statements Omit Historical Data

In the Disclosure Statement, debtor says that the business models for Gen, ETrans and GTrans have existed within the company as individual profit centers. (Disclosure Statement 5:6-10). Despite this, the pro-forma financial statements attached to the Disclosure Statement as Exhibit C have no historical comparisons. The financial picture of the LLCs is important because the LLCs are required to issue $2.7 billion in debt to pay the debtor's creditors. The ability of the LLCs to carry this obligation is best understood in light of their past financial performance. Pro forma financial results should be included for the LLCs.

F. The Disclosure Statement Fails to Disclose Potential Recoveries Against Debtor's Parent, PG&E Corp.

1. The First Priority Rule

The Disclosure Statement makes no mention whatsoever of any potential recoveries by debtor from its parent, PG&E Corp.[3] When PG&E Corp. was created as the holding company in 1996, debtor and PG&E Corp. agreed to abide by the so-called First Priority Rule set forth in CPUC Decision 96-11-017.[4] The First Priority Rule simply requires the holding company to give "first priority" to the capital requirements of the utility subsidiary. It is a necessary component of a holding company structure in the case of public utilities because by creating the holding company structure, the parent may deprive its new subsidiary of access to the public debt and equity market. *Id.* The Disclosure Statement does not contain any reference to the First Priority Rule.

The omission is difficult to justify in light of the substantial transfers from debtor to its parent prior to the filing of the bankruptcy case. According to Barrington-Wellesley Group, Inc.'s Review of Pacific Gas and Electric Company Financial Condition, issued January 30, 2001[5] at the request of the CPUC, the cash flow between the utility and its parent can be summarized as follows:

-From 1997 to 1999, debtor paid PG&E Corp. $4.0 billion in the form of dividends and repurchases of stock. During the same period, PG&E Corp. invested $0.8 billion in its non-regulated subsidiaries (other than debtor), $2.7 billion to buy back its stock from the public and $1.5 billion to pay dividends to its shareholders;

-In 1999, debtor generated $3.4 billion in cash, of which $1.3 billion was transferred to PG&E Corp. for common stock repurchases and dividends;

-In the first nine months of 2000, debtor generated $1.8 billion in cash, of which $632

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[3] The potential existence of claims cannot be gainsaid. Otherwise, the extensive Release and Exculpation clauses (Plan of Reorganization sections 11.5 and 11.7 (p. 72-73) would seem unnecessary.

[4] Debtor's representatives testified about the so-called First Priority Rule at the § 341(a) meeting; portions of the testimony were attached as Exhibit S to the *Request by Creditor City and County of San Francisco To Take Judicial Notice RE: [2953-1] Motion Of Certain Cities and Counties of the State of California for Issuance of an Order Directing the Appointment of An Official Committee of Government Creditors*, document #2959 on the PG&E docket web-site.

[5] The full Barrington-Wellesly Group Inc.'s report is available on the internet at the CPUC's web-site, http://www.cpuc.ca.gov/Word_Pdf/audit/pge_report.pdf. In the interests of economy of paper, the United States Trustee is not attaching a copy of the report but will make it available at the hearing if requested.

million was transferred to PG&E Corp. for common stock repurchases and dividends; and

-From 1997 to 2000, PG&E Corp. or other affiliates provided no cash to debtor.

The Disclosure Statement makes no mention of these transfers, any right debtor may have to recover on them, or to demand capital under the First Priority Rule, or any other cause of action debtor may have against its parent. The potential existence of such recoveries should be included in the Disclosure Statement, particularly in view of the "exculpation clause" and the releases found in the Plan. Debtor's failure to discuss these facts in spite of their materiality renders the Disclosure Statement inadequate.

______ 3. The SEC Investigation Into Public Utility Holding Company Act Violations Should Be Discussed

______Several reports have surfaced concerning the Attorney General of California's July 5, 2001 request that the Securities and Exchange Commission investigate the propriety of the relationship between debtor and PG&E Corp. The existence of an SEC investigation is a material fact in the evaluation of debtor's Plan and Disclosure Statement. Debtor should disclose the existence of any such investigation and its cooperation to date. If any outcome is known it should be disclosed, too.

G. The Disclosure Statement Does Not Disclose Why Most Recovery on Material Litigation Will be Forfeited by the Debtor

In the Disclosure Statement at pages 87 and 88 (Section H), debtor says it will transfer 95% of its rights in the filed-rate recovery litigation, BFM contract seizure litigation, and any claims against the state of California (presumably for failed regulation policies) to Newco or an affiliate. When all is said and done, Newco and the lawsuits will be owned by PG&E Corp, not debtor. The transfer must be difficult to justify in view of the significant costs the estate has already borne litigating these causes of action. Undoubtedly, additional legal expenses will be incurred prior to the date of transfer. Debtor's disclosure statement should disclose the total costs incurred to date and estimated to be incurred up until the time of transfer so that creditors can determine whether a retention of 5% of any potential recovery is a fair transaction or whether, for example, an agreement whereby debtor recoups all or a portion of its costs first and then allocates the remaining recovery proceeds 95/5 would be in the better

interest of creditors

H. Payment of Claims

The Disclosure Statement is vague on several points concerning the payment of claims. The document does not provide a firm date (calendar date) for the payment of claims. It also fails to state the dollar amount of notes a creditor will receive from each of the entities issuing debt. Instead, in footnote 1 on page 14, the document recites the percentage of notes each creditor will receive. In addition, the long term notes referred to in #5-7 of Exhibit D do not specify the length of the payment period (10, 20, or 30 years), nor which entity will pay its notes over which period of time.

I. The Disclosure Statement Does Not Describe the Claims Filed

The claims bar date in this case passed in September 2001. The company retained Berger & Associates as a claims processing agent. Despite this, the Disclosure Statement makes no attempt to recite the amount of claims that have been filed nor to sort them by class and amount. Thus, it is impossible to determine the amount of claims (versus what was scheduled) and the likely size of particular classes. This information is critical to determining whether debtor's plan is feasible. If debtor's projections of claims are low, the amount required to pay those claims may be greater than debtor has budgeted. Moreover, if the amount of claims is reduced, creditors should expect to be paid sooner.

J. The Descriptions of the Notes To Be Issued to Creditors Is Inadequate

Exhibit D to the Disclosure Statement does not adequately describe the notes that will be issued to creditors. The maturities of the notes are described as being between 10 and 30 years in length and the interest rate is said to be "market rate" for "comparable long-term notes". This description is insufficient because it does not say (1) which entity (that is, ETrans, GTrans or Gen) is issuing notes of which maturity, (2) how much of the issuances will be for longer terms (that is, 30 years) and how much for shorter terms (that is, 10 years) or (3) the exact interest rate that will be offered. The disclosure must be supplemented to be meaningful.

CONCLUSION

The Disclosure Statement should not be approved because it does not contain adequate information. The Disclosure Statement does not provide a meaningful basis for creditors to determine whether the proposed restructuring of the utility and its assets is appropriate, justified or fair. Debtor's failure to include a discussion of the value of assets being transferred to affiliates and other important details renders the document inadequate for the solicitation of votes by creditors.

Date:

LINDA EKSTROM STANLEY
UNITED STATES TRUSTEE

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Assistant United States Trustee

By: ______________________________
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