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**KEENAN G. CASADY, CLERK
UNITED STATES BANKRUPTCY COURT
SAN FRANCISCO, CA**

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 15 PACIFIC GAS AND ELECTRIC COMPANY

16 UNITED STATES BANKRUPTCY COURT
 17 NORTHERN DISTRICT OF CALIFORNIA
 18 SAN FRANCISCO DIVISION

19 In re
 20 PACIFIC GAS AND ELECTRIC
 21 COMPANY, a California corporation,
 22 Debtor.

No. 01-30923 DM
 Chapter 11 Case

DM

23 Federal I.D. No. 94-0742640

24 Adv. Proceeding No. **01**

3086

25 PACIFIC GAS AND ELECTRIC
 26 COMPANY, a California Corporation,
 27 Plaintiff,

28 v.

CALIFORNIA INDEPENDENT SYSTEM
 OPERATOR CORPORATION,
 Defendant.

COMPLAINT FOR INJUNCTIVE AND DECLARATORY RELIEF

COMPLAINT FOR INJUNCTIVE AND DECLARATORY RELIEF

HOWARD
 RICE
 NEMEROVSKI
 CANADY
 FALK
 & RABKIN
 Attorneys for Plaintiff, Debtor and Debtor in Possession

1 Pacific Gas and Electric Company, the plaintiff herein ("PG&E" or "Plaintiff"), alleges
2 as follows:

3 1. This is an adversary proceeding seeking declaratory and injunctive relief,
4 pursuant to 11 U.S.C. §§105 and 362(a) and Federal Rule of Bankruptcy Procedure 7001(7)
5 and (9).
6

7 **THE PARTIES**

8 2. Plaintiff is a corporation organized and existing under the laws of the State of
9 California with its principal place of business in San Francisco, California. Plaintiff is a
10 subsidiary of PG&E Corporation, a publicly-traded company listed on the New York Stock
11 Exchange. Plaintiff is engaged in the purchase, transmission, distribution, and sale of
12 electricity to the public within the meaning of the California Public Utilities Code. Plaintiff
13 provides retail electric service to approximately 4.5 million customers in Northern and
14 Central California.

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& RAIBIN
A Regional Corporation

15 3. Plaintiff is the debtor and debtor in possession in the Chapter 11 bankruptcy case
16 *In re Pacific Gas and Electric Company*, Bankruptcy Case No. 01-30923 DM (the
17 "Chapter 11 Case"), to which this adversary proceeding "relates" within the meaning of
18 Federal Rule of Bankruptcy Procedure 7008(a).

19 4. Plaintiff commenced the Chapter 11 Case by the filing of a voluntary petition
20 under Chapter 11 of Title 11 United States Code on April 6, 2001. As of the date of the
21 commencement of this adversary proceeding, the Chapter 11 Case remains pending in the
22 United States Bankruptcy Court for the Northern District of California, San Francisco
23 division, the Honorable Dennis Montali, United States Bankruptcy Judge, presiding.

24 5. Defendant California Independent System Operator Corporation ("ISO") is a not-
25 for-profit corporation validly existing under the laws of the State of California, which is
26 regulated by the Federal Energy Regulatory Commission ("FERC").
27
28

1 through the portion of retail rates that PG&E is permitted to charge its customers for such
2 generation-related costs.

4 GENERAL FACTUAL ALLEGATIONS

5 A. The Wholesale Power Market

6 12. PG&E owns, controls or has under contract approximately 11,300 megawatts of
7 electric generation capacity (including capacity from entities under contract with PG&E that
8 are presently seeking to avoid their obligations to supply PG&E with power), which is
9 sufficient to serve only between 50% and 60% of its retail load.

10 13. Since January 19, 2001, there have been (and continue to be) three sources of
11 wholesale electricity available for meeting total demand in PG&E's service territory:
12 (1) electricity from PG&E's own generation capacity—namely, electricity that PG&E
13 generates itself or obtains through contracts with third parties (its power purchase
14 agreements ("PPAs") and its bilateral contracts); (2) electricity that the State of California is
15 empowered to purchase through the Department of Water Resources ("DWR") and sell
16 directly to PG&E customers; and (3) electricity that the California Independent System
17 Operator procures from third parties, including "imbalance energy" that the ISO purchases
18 through the real-time wholesale energy market that it manages. The difference between the
19 amount of electric power PG&E can provide (e.g., through the generation facilities it owns,
20 and through contracts that it holds with third parties under PPAs and bilateral contracts), on
21 the one hand, and the amount of electric power required to serve PG&E's total retail load of
22 PG&E's customers, on the other, is commonly referred to as the "net open position" (or the
23 "net short position").

24 14. Under the restructuring of California's electricity industry, the ISO is charged
25 with responsibility for exercising centralized operational control of the statewide
26 transmission grid to assure electric reliability for the state (see Cal. Pub. Util. Code §345).
27 The ISO has been purchasing electricity to make up the shortfall that results whenever
28 customer demand has exceeded supply that PG&E can meet with its own generation and

1 electricity purchased by the DWR. The ISO continued to make such purchases after PG&E
2 initiated the Chapter 11 Case on April 6, 2001 and, on information and belief, it continues to
3 do so.

4 15. Virtually all of the costs that the ISO historically has billed to PG&E relate to the
5 ISO's procurement of electricity from third parties, including costs for "imbalance energy"
6 purchases on the spot market to meet the net open position, "ancillary services," and
7 congestion charges. (Prior to January 20, 2001, the ISO billed such costs to PG&E
8 indirectly, by billing them to the California Power Exchange Corporation ("the PX"), which
9 then billed such charges to PG&E; since January 20, 2001, PG&E has not been a participant
10 in the PX and the ISO began to bill such charges directly to PG&E).

11 16. The real-time energy market managed by the ISO, and the wholesale prices that
12 the ISO incurs, are subject to exclusive federal regulation by the Federal Energy Regulatory
13 Commission under the Federal Power Act.

14 17. The ISO's operations and billing procedures, including the pricing for each type
15 of electricity and services it purchases for PG&E, are set forth, and governed by, a tariff that
16 the ISO has filed with FERC ("the ISO Tariff"). Section 2.2.3.2 of the ISO Tariff requires
17 PG&E to meet certain creditworthiness requirements. PG&E does not currently meet those
18 requirements and has not met them since at least January 17, 2001.

19
20 **B. The Electricity Market Crisis**

21 18. Beginning in June 2000, a combination of market conditions caused wholesale
22 prices for electricity in California to increase dramatically. In the last nine months, PG&E's
23 average costs of purchasing wholesale electricity were more than five times higher than in
24 the comparable periods during the past two years.

25 19. To date, the California Public Utilities Commission has refused to authorize or
26 implement retail rate increases sufficient to enable PG&E to recover its wholesale electricity
27 costs from its retail customers.

28 20. During the period April 6 through April 30, 2001, the ISO purchased power on

1 the spot market at rates as high as 51.3¢ per kilowatt hour (“kWh”), and at an average cost of
2 approximately 38.5¢ cents per kWh. Retail rates recoverable by PG&E to pay for such costs
3 are currently frozen at an average energy rate of 6.471¢ per kWh. On March 27, 2001, the
4 CPUC approved an average 3¢ per kWh increase which will bring the average energy rate to
5 9.471¢ per kWh when implemented.

6 21. Based on an average energy retail rate of 6.471¢ per kWh, and PG&E’s April
7 2001 estimated net short position, if the ISO were to purchase 5% of the projected net open
8 position at the foregoing 38.5¢ average spot market price, the cost of such ISO purchases, if
9 passed on to PG&E, would exceed the revenues from retail energy rates and would cause
10 PG&E to lose approximately \$50 million per month from the acquisition and delivery of that
11 imbalance energy. If the ISO were to purchase 25% of the projected net open position, the
12 cost of such ISO purchases, if passed on to PG&E, would cause PG&E to lose
13 approximately \$252 million per month from the acquisition and delivery of that imbalance
14 energy.

15 22. Based on an average energy retail rate of 9.471¢ per kWh, and PG&E’s April
16 2001 estimated net short position, if the ISO were to purchase 5% of the projected net open
17 position at the foregoing 38.5¢ average spot market price, the cost of such ISO purchases, if
18 passed on to PG&E, would exceed the revenues from retail energy rates and would cause
19 PG&E to lose approximately \$46 million per month from the acquisition and delivery of that
20 imbalance energy. If the ISO were to purchase 25% of the projected net open position, the
21 cost of such purchases, if passed on to PG&E, would cause PG&E to lose approximately
22 \$228 million per month from the acquisition and delivery of that imbalance energy.

23 23. Under any of the foregoing scenarios, if the ISO also is permitted to pass on to
24 PG&E other related costs associated with the ISO’s procurement of power from third parties
25 (such as costs associated with ancillary services and other costs), then PG&E would lose up
26 to an additional approximately \$110 million per month in additional costs associated with
27 DWR’s pro rata share of such costs—unless the ISO were to allocate these other costs to,
28 and bill, DWR. On information and belief, the ISO is not making any such allocations.

1 24. PG&E notes that on April 26, 2001, FERC issued an order addressing price
2 mitigation and market stabilization in California's wholesale markets. That order will
3 undoubtedly be the subject of requests for rehearing and, in any event, it is unclear whether
4 that order, if and when implemented, will be effective in reducing the prices paid for power
5 in California markets. PG&E does not believe that the order, if and when implemented, will
6 eliminate the problems that are the subject of this action.

7
8 **C. Wholesale Power Purchases By the State of California**

9 25. Beginning in January 2001, the State of California, through the California
10 Department of Water Resources, has been purchasing wholesale electric power to be
11 provided directly to electric customers in PG&E's service territory. These DWR activities
12 were first authorized in the Governor's Emergency Proclamation issued by Governor Davis
13 on January 17, 2001, then for a very limited period of time through enactment of Senate
14 Bill 7 ("SB 7x") adopted in the First 2001-2002 Extraordinary Session of the California
15 Legislature, and finally on an ongoing basis through enactment of Assembly Bill 1
16 ("AB 1x"), adopted by the California Legislature on February 1, 2001.

17 26. AB 1x empowers the DWR to recover all of the costs it deems necessary to fund
18 its power purchases, to advise the CPUC of its financial needs (its so-called "revenue
19 requirement"), and to expect, in turn, that the CPUC will raise retail rates to the extent
20 necessary to facilitate DWR's power purchases. *See* Water Code §§80110, 80134. The
21 CPUC has acknowledged that it has no authority to second-guess the reasonableness of the
22 State's power purchases under AB 1x, and that it must ensure that the State's revenue
23 requirements are met, including by raising rates if necessary.

24 27. To date, DWR has not committed to purchase sufficient electricity to meet the net
25 short position. Instead, the DWR has stated publicly, as recently as the week of April 16,
26 2001, that it is limiting its purchases only to power that is sold at what the DWR deems is a
27 "reasonable" rate. On information and belief, the ISO has been purchasing the remaining
28 wholesale electric power necessary to meet the net short position at extremely high rates—at

1 the very same wholesale rates that the DWR refuses to pay.

2
3 **D. The FERC Orders**

4 28. Recent rulings by FERC confirm that the ISO cannot lawfully continue to
5 purchase any power on behalf of PG&E given PG&E's financial circumstances. However,
6 significant uncertainty exists as to ISO's continued intentions in this regard.

7 29. The ISO's March 1998 Tariff contains a "creditworthiness" requirement as to
8 those entities on whose behalf ISO makes wholesale power purchases. As of January 16,
9 2001, PG&E no longer meets the ISO's definition of "creditworthy" because, on that date,
10 Standard and Poor's Corporation and Moody's Investment Service reduced PG&E's credit
11 rating to below investment-grade status. On February 14, 2001, FERC issued an order (the
12 "FERC Order"(reported at 94 FERC ¶61,132, 2001 WL 275661)) holding that the ISO could
13 not exempt PG&E from the ISO's requirements that those obtaining electric power through
14 the ISO must be "creditworthy." The order, therefore, stands for the proposition that, since
15 at least January 21, 2001, PG&E could not be financially responsible for power purchases
16 made by the ISO. A true and correct copy of that order is attached hereto as Exhibit A.

17 30. On April 6, 2001, FERC ordered the ISO to comply with its February 14, 2001
18 Order. In its April 6 ruling, FERC emphasized that the February 14 Order applied to *all*
19 energy delivered through the ISO by third-party suppliers, and specifically noted that it "did
20 not exempt any transactions from the requirement to have in place a creditworthy buyer,"
21 but instead "provided third-party suppliers assurances of a creditworthy buyer for all energy
22 delivered to the loads through the ISO." A true and correct copy of that order is attached
23 hereto as Exhibit B.

24 31. One week after FERC's April 6 ruling, the DWR authorized the ISO on April 13,
25 2001 to issue a "Market Notice re Credit Issues," a true and correct copy of which is
26 attached hereto as Exhibit C, stating that DWR would (a) assume financial responsibility
27 only for those ISO purchases in its ancillary services and imbalance energy markets that are
28 not "paid . . . or payable by" another creditworthy party, *and that DWR determines, on a*

1 *case-by-case basis, are "reasonable,"* and (b) assume financial responsibility for all
2 purchases resulting from emergency dispatch instructions, "to the extent not paid or payable
3 by" another creditworthy party. That notice also states that "[t]he ISO and/or DWR reserve
4 the right to rescind or modify the foregoing arrangements at any time and for any reason,
5 including a successful rehearing or appeal from the April 6 order."

6 32. Following the issuance of the FERC Order, PG&E sought assurances from the
7 ISO that it would not continue to purchase power on PG&E's behalf, including at costs
8 above what PG&E is currently authorized to recover through the portion of retail rates that
9 PG&E is permitted to charge its customers for such generation-related costs, but the ISO has
10 failed to provided satisfactory assurances.

11 33. On April 19, 2001, the ISO advised PG&E that: "To the extent that PG&E does
12 not generate and schedule sufficient energy to serve [its] load, power purchases are made on
13 PG&E's behalf to meet the deficiency and PG&E, as the provider of last resort, is the
14 responsible party to pay for the cost of such power To the extent that the invoices
15 submitted for third-party power purchases are covered by the automatic stay issued by the
16 Bankruptcy Court, please consider those invoices as submitted for purposes of PG&E's
17 records." A true and correct copy of such letter is attached hereto as Exhibit D.

18 34. On April 26, 2001, in response to the ISO's April 13, 2001, "Market Notice re.
19 Credit Issues," and in response to certain revisions to its tariff that the ISO had submitted
20 after the February 14, 2001 Order, Michael Coleman, Director, Division of Tariffs and
21 Rates - West, of the Federal Energy Regulatory Commission, wrote a letter to the ISO, a
22 copy of which is attached hereto as Exhibit E, directing the ISO to revise its tariffs within 15
23 days from the date of the letter, in order to comply fully with the FERC's February 14 and
24 April 6, 2001 order regarding creditworthiness standards for unscheduled transactions
25 engaged in by the ISO. In particular, the April 26, 2001 FERC letter requires the ISO
26 compliance filing to "incorporate all arrangements or agreements between the ISO and DWR
27 in regard to the above mentioned market notification, as well as all purchasing agreements
28 on behalf of Pacific Gas and Electric Company or Southern California Edison Company. In

1 addition, the compliance filing should be amended to include all procedures instituted by the
2 ISO that ensure that DWR is afforded the same non-preferential treatment as other market
3 participants, especially power purchasers.”

4 35. Upon information and belief, the ISO intends to hold PG&E financially
5 responsible for all post-petition costs, including imbalance energy costs, that the ISO incurs
6 to meet the net open position, despite the fact that PG&E receives no direct economic benefit
7 from such purchases, and despite that PG&E is not currently permitted to recover the full
8 cost of such purchases through the portion of retail rates that PG&E is permitted to charge its
9 customers for such generation-related costs.

10
11 **FIRST CAUSE OF ACTION**
12 **(Permanent Injunction Against Charging PG&E For Power In Violation of The ISO**
Tariff, Federal Law And The FERC Order)

13 36. Plaintiff repeats and realleges the facts set forth in paragraphs 1 through 35 above
14 and incorporates them in this Count as if set forth in full herein.

15 37. Pursuant to the ISO Tariff and the February 14, 2001 FERC Order described
16 above, the ISO is prohibited and preempted by federal law from charging PG&E for
17 wholesale electric power that the ISO purchases.

18 38. By continuing to charge PG&E for high-priced purchases of wholesale power
19 made by the ISO, the ISO has violated applicable federal law, for which no adequate remedy
20 at law exists, entitling PG&E to an injunction permanently enjoining the ISO from charging
21 PG&E for power in violation of the FERC Order and applicable federal law.

22 WHEREFORE, Plaintiff requests an injunction permanently enjoining the Defendant
23 from requiring PG&E to pay for costs incurred by the ISO in connection with the ISO's
24 wholesale power purchases, as more particularly prayed for below.

25
26 **SECOND CAUSE OF ACTION**
27 **(Declaratory Relief—Violation of the Automatic Stay Imposed by Section 362(a)(3))**

28 39. Plaintiff repeats and realleges the facts set forth in paragraphs 1 through 35 above

COMPLAINT FOR INJUNCTIVE AND DECLARATORY RELIEF

1 and incorporates them in this Court as if set forth in full herein.

2 40. This is a claim for declaratory relief brought under the provisions of 28 U.S.C.
3 §2201 and 11 U.S.C. §362(a).

4 41. An actual controversy has arisen and now exists between the parties relating to
5 the legal rights and duties of PG&E and Defendant for which PG&E seeks a judicial
6 declaration of rights as to such matters, as well as further necessary or proper relief,
7 including injunctive relief.

8 42. A declaratory judgment is necessary and appropriate at this time in that PG&E
9 contends, and on information and belief Defendant denies, that during the pendency of
10 PG&E's Chapter 11 case, the automatic stay imposed pursuant to Section 362(a)(3) of the
11 Bankruptcy Code precludes the Defendant from procuring and then requiring PG&E to
12 accept and pay for wholesale power, including imbalance energy, purchased by the ISO at
13 costs that PG&E cannot fully recover through the portion of retail rates that PG&E is
14 permitted to charge its customers for such generation-related costs, and from accruing post-
15 petition debt on PG&E's behalf for such costs. In particular, PG&E contends, and on
16 information and belief Defendant denies, that such actions constitute actions to obtain
17 control over PG&E and property of its Chapter 11 estate and are not subject to any statutory
18 exception to the automatic stay.

19 WHEREFORE, PG&E prays for declaratory judgment as set forth below.

20
21 **THIRD CAUSE OF ACTION**
22 **(Permanent Injunction Pursuant to Section 105(a) of the Bankruptcy Code)**

23 43. Plaintiff repeats and realleges the facts set forth in paragraphs 1 through 35 above
24 and incorporates them in this Court as if set forth in full herein.

25 44. Any action by Defendant to procure for and then seek to compel PG&E to pay for
26 or become obligated to the ISO for post-petition costs expended by the ISO in connection
27 with purchases of wholesale power, including imbalance energy, that PG&E cannot fully
28 recover through the portion of retail rates that PG&E is permitted to charge its customers for

1 such generation-related costs, or to accrue such post-petition debt on PG&E's behalf, are
2 illegal and improper because (a) Section 503 of the Code prohibits PG&E from paying ISO
3 for any such purchases because such payments are not in the best interests of the estate;
4 (b) any further power purchases by the ISO under the circumstances described herein would
5 constitute an unauthorized post-petition use of PG&E's property in violation of Section
6 363(b) of the Code; and (c) would violate Section 364 of the Code, because they would force
7 PG&E to undertake credit on onerous terms.

8 45. Any such action would also interfere with both property of PG&E's Chapter 11
9 estate and this Court's administration of the reorganization process.

10 46. Plaintiff has no adequate remedy at law.

11 47. Plaintiff will suffer irreparable injury if the preliminary and permanent injunction
12 sought herein is not granted in that requiring PG&E to pay for any costs of wholesale power
13 purchases made by the ISO for which PG&E derives no direct benefit, and cannot recover
14 through the portion of retail rates that PG&E is permitted to charge its customers for such
15 generation-related costs, violates Sections 363(b)(1), 364(b), and 503(b)(1) of the Code, and
16 thus is prejudicial to the bankruptcy process and to those charged with administration of the
17 bankruptcy estate.

18 48. No real substantial harm to the Defendant can be demonstrated, as weighed
19 against the harm to the federal interests involved, including but not limited to maximization
20 of the value of the Chapter 11 estate for all parties in interest in this reorganization
21 proceeding, certainty at the outset of this proceeding that the value of the Chapter 11 estate
22 will not be depleted, and preservation of the jurisdiction of this Court over property of the
23 estate.

24 49. The public interest will not be adversely affected by the granting of the
25 injunction.

26 50. The activity sought to be enjoined herein threatens to prejudice the bankruptcy
27 process or PG&E's ability to reorganize, threatens to disrupt or destroy the reorganization
28 process, threatens property of the estate necessary to a Chapter 11 plan, and interferes with

1 the jurisdiction of the Bankruptcy Court. Procuring for and then requiring PG&E to pay for
2 costs incurred in connection with any wholesale power purchases made by the ISO, at costs
3 that PG&E is unable to recover through the portion of retail rates that PG&E is permitted to
4 charge its customers for such generation-related costs, or permitting the ISO to accrue such
5 post-petition debt on behalf of PG&E, would frustrate not only the rehabilitative intent of
6 Chapter 11, but the very purpose for which PG&E filed for Chapter 11 protection—that is,
7 to provide a fair, consolidated, orderly and consistent process by which PG&E may address
8 and resolve its responsibilities and liabilities, for the benefit of all creditors of the Chapter 11
9 estate.

10 WHEREFORE, Plaintiff requests an injunction preliminarily and permanently
11 enjoining the Defendant from requiring PG&E to pay for costs incurred by the ISO in
12 connection with the ISO's wholesale power purchases at costs that PG&E cannot recover
13 through the portion of retail rates that PG&E is permitted to charge its customers for such
14 generation-related costs, as more particularly prayed for below.

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Attorneys at Law

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17 **PRAYER FOR RELIEF**

18 WHEREFORE, PG&E prays for relief as follows:

19 1. That the court permanently enjoin the ISO and each of its agents, servants,
20 employees and attorneys and those persons in active concert or participation with the ISO,
21 from charging PG&E for power in violation of the ISO Tariff, the PERC Order and
22 applicable federal law;

23 2. That the court declare that any attempt by the Defendant (and each of its agents,
24 servants, employees and attorneys and those persons in active concert or participation with
25 them) to procure for and then compel PG&E (or any of its employees, agents, officers and
26 directors) to accept and pay for purchases of wholesale power, including associated ancillary
27 services, by the ISO at costs that PG&E cannot fully recover through the portion of retail
28 rates it is permitted to charge for such generation-related costs is automatically stayed

1 pursuant to 11 U.S.C. §362(a), including, without limitation, any attempt by the ISO to
2 accrue post-petition debt on PG&E's behalf for any such wholesale power purchases.

3 3. That the court preliminarily and permanently enjoin the Defendant and each of its
4 agents, servants, employees and attorneys and those persons in active concert or
5 participation with it, from procuring for and compelling PG&E (or any of its employees,
6 agents, officers and directors) to accept and pay for purchases of any wholesale power,
7 including associated ancillary services, by the ISO at costs that PG&E cannot fully recover
8 through the portion of retail rates that PG&E is permitted to charge for such generation-
9 related costs, including, without limitation, any attempt to accrue post-petition debt on
10 PG&E's behalf for such wholesale power purchases.

11 4. That the court preliminarily and permanently enjoin the Defendant and each of its
12 agents, servants, employees and attorneys and those persons in active concert or
13 participation with it, from taking or continuing any action in any court or administrative
14 tribunal other than this Court to seek a determination that (a) Sections 362(a)(3) or 105(a) of
15 the Bankruptcy Code are inapplicable or not binding on Defendant; (b) that Section
16 362(b)(4) of the Code applies to the actions of the Defendant as more fully alleged herein; or
17 (c) that an stay or injunction entered in this action be lifted; and

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HOWARD
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& RAIRIN
A National Corporation

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5. For such other and further relief as the Court deems just and proper.

DATED: May 2, 2001.

Respectfully,

JEROME B. FALK, JR.
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