IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF MARYLAND
(Greenbelt Division)

In re:	)	
USGen New England, Inc.,	)	Case No. 03-30465 (PM)
Debtor.	)	Chapter 11

DEBTOR'S MOTION PURSUANT TO SECTION 365 OF THE BANKRUPTCY CODE FOR ORDER AUTHORIZING DEBTOR TO REJECT QUEBEC INTERCONNECTION TRANSFER AGREEMENT

USGen New England, Inc., debtor and debtor in possession (the "Debtor"), by and through its undersigned attorneys, files this Motion Pursuant to Section 365 of the Bankruptcy Code for Order Authorizing Debtor to Reject Quebec Interconnection Transfer Agreement (the "Motion"), and states as follows:

JURISDICTION AND VENUE

1. This Court has jurisdiction over this Motion pursuant to 28 U.S.C. §§ 157 and 1334. Venue is proper before this Court pursuant to 28 U.S.C. §§ 1408 and 1409. This matter is a core proceeding pursuant to 28 U.S.C. § 157(b)(2). The statutory predicate for the relief sought in this Motion is § 365 of title 11 of the United States Code (the "Bankruptcy Code"), as complemented by Rule 6006 of the Federal Rules of Bankruptcy Procedure.

BACKGROUND

The Chapter 11 Case

2. On July 8, 2003 (the "Petition Date"), the Debtor filed with this Court a voluntary petition for relief under chapter 11 of the Bankruptcy Code. Pursuant to §§ 1107 and

1108 of the Bankruptcy Code, the Debtor is continuing to operate its business and manage its properties as a debtor in possession. No trustee or examiner has been appointed in the Debtor's chapter 11 case. On July 17, 2003, the Office of the United States Trustee appointed an official committee of unsecured creditors in the Debtor's chapter 11 case.

The Debtor and Its Business Operations

The Debtor's Formation and Business

3. The Debtor was incorporated on August 1, 1997 for the purpose of acquiring and operating the non-nuclear generating business of New England Electric System. The Debtor is an indirect, wholly-owned subsidiary of PG&E National Energy Group, Inc.

4. The Debtor is in the business of owning and operating electric generating facilities in New England (the "Facilities") and buying and selling electricity and other energy-related products at wholesale. All of these Facilities are located and all of the Debtor's significant sales take place in New England.

The Debtor's Generating Facilities

5. The Debtor owns three Facilities (Brayton Point Station, Salem Harbor Station and Manchester Street Station) that use coal, oil or natural gas for fuel. The Debtor also owns two hydroelectric systems, one of which spans the Connecticut River (Connecticut River System) and one of which spans the Deerfield River (Deerfield River System), and leases the Bear Swamp pumped-storage facility.

SUMMARY OF QUEBEC INTERCONNECTION TRANSFER AGREEMENT

6. The Debtor is a party to the Quebec Interconnection Transfer Agreement with New England Power Company ("NEP") dated September 1, 1998 (the "Transfer Agreement"). A copy of the Transfer Agreement is attached to this Motion as Exhibit "A". Pursuant to the Transfer Agreement, NEP reassigned to the Debtor its benefits, rights, and

privileges under various agreements to transmit electric energy on certain high voltage direct current interconnection facilities electrically connecting Hydro-Quebec, a Canadian utility, to utilities in the Northeastern United States (at the Comerford Generating Station in New Hampshire and at the Sandy Pond Substation in Massachusetts) that were built and are owned by other entities (the "HVDC Facilities"), together with certain of NEP's corresponding financial obligations thereunder to pay the owners of those facilities for those transmission use rights (the "HVDC Agreements").

7. Under the HVDC Agreements, NEP has the right to use approximately 18% of the transmission capacity of the HVDC Facilities and an obligation to pay to the owners of the HVDC Facilities, on a monthly basis, a corresponding percentage of the operation, maintenance, and capital costs of these facilities (the "Support Payments").

8. Pursuant to the Transfer Agreement, the Debtor has the right to use NEP's transmission use rights in the HVDC Facilities and is obligated to pay to NEP amounts equal to the Support Payments NEP is required to pay to the owners of the HVDC Facilities. The Debtor is required by the Transfer Agreement to make these payments to NEP even if the Debtor does not use all (or any) of the reassigned transmission use rights. The Transfer Agreement did not transfer to the Debtor any ownership, operation or control rights in the HVDC Facilities, and the Debtor does not own, operate, or control such facilities; rather, it is a transmission customer of the owners of the HVDC Facilities.

9. The Transfer Agreement remains in effect until all payments required thereunder by the Debtor and NEP to each other for the last month in which the HVDC Agreements remain in effect are made. The HVDC Agreements (and hence the Transfer Agreement) terminate in December 2020.

10. As noted, the Debtor is required to make the Support Payments under the HVDC Agreements regardless of whether the underlying transmission capacity is used. Since 2001, the Debtor has not needed the transmission capacity.

11. Based on the twelve month period ending June 2003, the Transfer Agreement represents an above-market, annual net cost to the Debtor in excess of approximately $10,000,000. Moreover, the Transfer Agreement will continue to result in a sizable above-market, net cost to the Debtor for the remaining term of the agreement.

RELIEF REQUESTED

12. By this Motion, the Debtor seeks entry of an order pursuant to § 365 of the Bankruptcy Code authorizing and approving the rejection of the Transfer Agreement described above and further identified in Exhibit "A" attached hereto. The Debtor requests that rejection be made effective as of the hearing date on the Motion.

13. The Transfer Agreement pertains to rights to use high voltage interconnection facilities to transmit energy on a wholesale basis. The Transfer Agreement does *not* relate to or involve sales of power to traditional public utilities that serve retail load. For this reason, this Motion involves a situation different from that which arose in the recent Federal Energy Regulatory Commission ("FERC") proceedings where an affiliate of NRG Energy, Inc. (NRG Power Marketing, Inc. ("NRG-PMI")) sought to reject a contract where it was the power seller in its chapter 11 case pending in the United States Bankruptcy Court for the Southern District of New York. There, NRG-PMI, a "public utility" regulated by FERC pursuant to Part II of the Federal Power Act, was attempting to reject a contract pursuant to which it sold energy to a traditional public utility for resale to the public at retail. FERC refused to allow NRG-PMI to cease energy sales under the contract because of its concern that NRG-PMI's abandonment of service under the contract would adversely affect the retail customers of the power purchaser, a

traditional public utility. The instant Motion, which involves a request to cease use of certain wholesale transmission rights, does not raise such public interest concerns.

APPLICABLE AUTHORITY/ BASIS FOR RELIEF REQUESTED

14. Section 365(a) of the Bankruptcy Code provides that a debtor in possession, "subject to the court's approval, may assume or reject any executory contract ... of the debtor." 11 U.S.C. § 365(a).

15. It is well-settled in this Circuit that the business judgment rule applies to a debtor's decision to reject an executory contract or unexpired lease; absent a showing of gross abuse or bad faith, the debtor's decision must stand. *See Lubrizol Enterprises, Inc. v. Richmond Metal Finishers, Inc. (In re Richmond Metal Finishers, Inc.)*, 756 F.2d 1043, 1046 (4th Cir. 1985); *see also In re U.S. Airways Group, Inc.*, 287 B.R. 643, 645 (Bankr. E.D. Va. 2002) (court approved debtor airline's motion to, *inter alia,* reject aircraft leases); *In re Harborview Development 1986 Ltd. Partnership*, 152 B.R. 897, 899 (D.S.C. 1993) (court affirmed bankruptcy court decision authorizing chapter 11 trustee to abandon debtor's lease of commercial property to insider corporation); *In re Hardie,* 100 B.R. 284, 287 (E.D.N.C. 1989) (court approved debtor's rejection of executory contract based on sound business judgment). In the oft-cited *Lubrizol* opinion, the Fourth Circuit articulated the business judgment rule as follows:

> Courts addressing [the rejection issue] must start with the proposition that the bankrupt's decision upon it is to be accorded the deference mandated by the sound business judgment rule as generally applied by courts to discretionary actions or decisions of corporate directors. *See Bildisco*, 465 U.S. at ----, 104 S.Ct. at 1195 (noting that the business judgment rule is the "traditional" test); *Group of Institutional Investors v. Chicago, Milwaukee, St. Paul & Pacific Railroad*, 318 U.S. 523, 550, 63 S.Ct. 727, 742, 87 L.Ed. 959 (1943) (applying business judgment rule to bankrupt's decision whether to affirm or reject lease)...

> As generally formulated and applied in corporate litigation the rule is that courts should defer to--should not interfere with--decisions of corporate directors upon matters entrusted to their business judgment except upon a finding of bad faith or gross abuse of their "business discretion." *See, e.g., Lewis v. Anderson,* 615 F.2d 778, 782 (9th Cir. 1979); *Polin v. Conductron Corp.,* 552 F.2d 797, 809 (8th Cir. 1977). Transposed to the bankruptcy context, the rule as applied to a bankrupt's decision to reject an executory contract because of perceived business advantage requires that the decision be accepted by courts unless it is shown that the bankrupt's decision was one taken in bad faith or in gross abuse of the bankrupt's retained business discretion.

Lubrizol, 756 F.2d at 1046-47.

16. This Court applies the business judgment rule set forth in *Lubrizol* as a matter of course. As Judge Schneider has explained:

> In determining whether to permit a debtor to reject an executory contract, the Court defers to the debtor's sound business judgment. This rule has generally been applied by courts to discretionary actions and decisions in the realm of corporate litigation, as well as to a debtor's decision to affirm or reject an executory contract. *Lubrizol, supra*, at 1046-47. The issue is "whether the decision of the debtor that rejection will be advantageous is so manifestly unreasonable that it could not be based on sound business judgment, but only on bad faith, or whim or caprice." *Id.* at 1047.

In re Constant Care Community Health Center, Inc., 99 B.R. 697, 702 (Bankr. D. Md. 1989) (J. Schneider) (citations omitted); *see also In re Merry-Go-Round Enterprises*, 241 B.R. 124, 130 (Bankr. D. Md. 1999) (J. Derby) *citing Lubrizol,* 756 F.2d 1043 at 1046. ("This court allowed [debtor] to assume the leases because it found that [debtor] had used sound business judgment in determining that assuming each of the leases was in the best interest of the estate").

17. Courts in other jurisdictions similarly apply the business judgment standard and accord deference to the debtor's business judgment when evaluating a motion to reject a lease or executory contract. *See, e.g., National Labor Relations Board v. Bildisco (In re Bildisco),* 682 F.2d 72, 79 (3d Cir. 1982), *aff'd,* 465 U.S. 513 (1984) ("[t]he usual test for rejection of an executory contract is simply whether rejection would benefit the estate, the

'business judgment' test"); *In re Crystallin, LLC,* 293 B.R. 455, 464 (B.A.P. 8th Cir. 2003) (if the debtor establishes that rejection of an executory contract is of benefit to the estate, then the bankruptcy court should not interfere with the debtor's business judgment except upon a finding of bad faith or gross abuse of business discretion, *citing Lubrizol,* 756 F.2d at 1046-47); *In re HQ Global Holdings, Inc.,* 290 B.R. 507, 511 (Bankr. D. Del 2003) (the sole issue to consider when evaluating a motion to reject an executory contract under the business judgment test is whether the rejection will benefit the estate); *In re Central Jersey Airport Services, LLC,* 282 B.R. 176 (Bankr. D.N.J. 2002) (court found that debtor met its burden of showing that rejection benefited the estate); *In re Trans World Airlines, Inc.,* 261 B.R. 103, 121 (Bankr. D. Del. 2001) (a debtor's decision to reject an executory contract should be summarily affirmed unless it is the product of "bad faith, or whim or caprice," *citing Wheeling-Pittsburgh Steel Corp. v. W. Penn Power Co. (In re Wheeling-Pittsburgh Steel Corp.),* 72 B.R. 845, 849-50 (Bankr. W.D. Pa. 1987)); *In re Chipwich, Inc.* 54 B.R. 427, 430-31 (Bankr. S.D.N.Y. 1985) (debtor's business judgment should not be interfered with absent showing of bad faith or abuse of business discretion); *Commercial Fin., Ltd. v. Hawaii Dimensions, Inc. (In re Hawaii Dimensions, Inc.),* 47 B.R. 425, 427 (D. Haw. 1985) ("[u]nder the business judgment test, a court should approve a debtor's proposed rejection if such rejection will benefit the estate") (citation omitted); *see also In re Federated Department Stores, Inc.,* 131 B.R. 808, 813 (S.D. Ohio 1991); *In re Condominium Association of Plaza Towers South, Inc.,* 43 B.R. 18, 21 (S.D. Fla. 1984); *In re J.H. Land & Cattle Co., Inc.,* 8 B.R. 237, 238 (Bankr. Okla. 1981).

18. Upon review and analysis of the Debtor's obligations under the Transfer Agreement, the Debtor has concluded that the relief requested in this Motion is in the best interests of the Debtor, its estate and its creditors. Elimination of the Debtor's payment obligations under the Transfer Agreement, which are above-market, will alleviate significant

economic burdens on the Debtor and its estate, as the Debtor will avoid incurring unnecessary administrative costs associated with the Transfer Agreement which may otherwise accrue under such agreements. Moreover, the Debtor simply no longer requires the transmission capacity which is provided under the Transfer Agreement. The Transfer Agreement is not necessary to ensure that the Debtor will have an adequate supply of energy available to meet its obligations as the Debtor believes it can generate what it needs itself and, on the infrequent occasions where it would have a shortfall, it is more economic for the Debtor to cover such shortfall by making market purchases and making alternative arrangements for delivered energy. The Transfer Agreement imposes excessive cost and expense to the Debtor's estate without corresponding benefits. Thus, the Transfer Agreement is neither needed nor desirable for the Debtor's continued operations.

19. In short, the Debtor has determined, in the reasonable exercise of its sound business judgment, that the Transfer Agreement is burdensome and provides no economic value to its estate. Accordingly, the Debtor requests authority to reject the Transfer Agreement effective as of the date of this Court's hearing on the Motion.

20. If the Court grants this Motion, the Debtor respectfully requests that the Transfer Agreement be deemed rejected pursuant to the attached proposed order.

21. Pursuant to Local Rule 9013-2, no memorandum of law accompanies this Motion.

WHEREFORE, the Debtor respectfully requests entry of an order (a) authorizing the Debtor to reject the Transfer Agreement and (b) granting the Debtor such other and further relief as this Court may deem just and proper.

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CERTIFICATE OF SERVICE

I hereby certify that on this 5th day of September, 2003, a copy of the foregoing Motion Pursuant to Section 365 of the Bankruptcy Code for Order Authorizing Debtor to Reject Quebec Interconnection Transfer Agreement was e-mailed to the parties on the updated Service List filed in this case [Dkt. No. 246], with a hard copy following by first class postage pre-paid mail. On September 5, 2003, a hard copy of the Motion was also served by first class, postage prepaid mail on New England Power Company, as counterparty to the Quebec Interconnection Transfer Agreement, at the addresses set forth on the attached page.

/s/ John Lucian

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